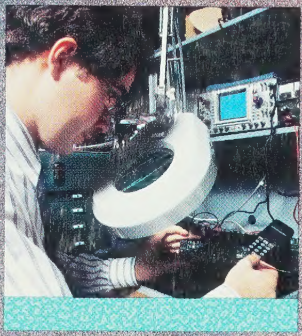
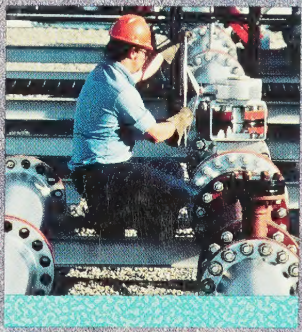
N ALBERTA CORPORATION

ANNUAL REPORT 1986





Annual Meeting

The Company's annual meeting will be held on Thursday, June 18, 1987, at 10:30 a.m. in the Palliser Hotel, 133 Ninth Avenue S.W., Calgary, Alberta.

The Cover

The photographs on the cover are of NOVA people at work. They appear with captions in the text of this annual report.

Contents

Dollar amounts in this report are stated in Canadian dollars unless otherwise specified.

Measurements throughout the report are stated in imperial units, as most of our shareholders have expressed a preference for this system.

NOVA, AN ALBERTA CORPORATION

Incorporated by special act of the Province of Alberta, NOVA is a major Canadian shareholder-owned energy company headquartered in Calgary.

The Company was formed in 1954 to build, own and operate a province-wide natural gas transportation system. In recent years, we have expanded our business base through new energy-related investments.

Current areas of activity include gas transportation and marketing, petroleum, petrochemicals, manufacturing, consulting and research.

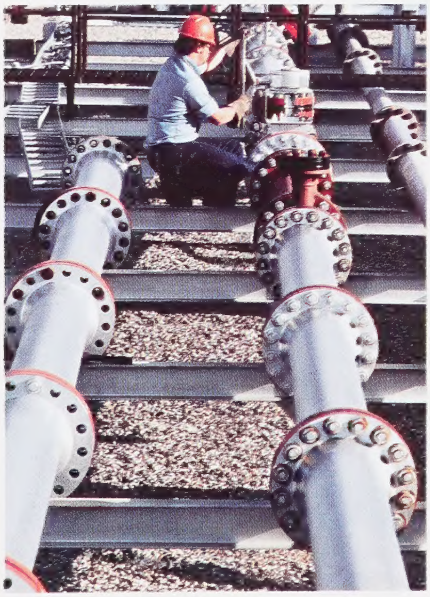
NOVA shares trade on the Toronto, Montreal and Alberta stock exchanges. Assets total $4.8 billion and our companies employ about 7,100 people.

Consolidated Financial Highlights

(Thousands of dollars except for share data)

	Total	
Year Ended December 31	1986	1985
Operating revenue	$2,680,966	$3,347,236
Net operating income	$ 573,221	$ 673,572
Income before unusual items	$ 138,122	$ 134,111
Unusual items	$ (30,125)	$ —
Income before extraordinary items	$ 107,997	$ 134,111
Extraordinary items	$ (7,800)	$ (216,522)
Net income (loss)	$ 100,197	$ (82,411)
Earnings (loss) per common share		
Before extraordinary items		
Basic	$ 0.18	$ 0.38
Fully diluted	$ 0.17	$ 0.38
After extraordinary items		
Basic	$ 0.12	$ (1.31)
Fully diluted	$ 0.12	$ (1.31)
Dividends paid per Class "A" common share	$ 0.40	$ 0.40
Average number of common shares outstanding (thousands)	134,655	128,087

Calgary '88
OFFICIAL SPONSOR



NOVA's full-scale gas dynamics test facility at Didsbury, Alberta, allows researchers to conduct extensive field tests of new technology for gas pipelines.

Summary

Earnings to common shareholders continued to be depressed by low world commodity price trends throughout 1986. Although production and operations performances were good, NOVA's common share price stayed low throughout the year.

On the recommendation of management, the Board approved the maintenance of the common dividend rate at 40 cents per share in 1986. In 1987 we expect this dividend rate will be covered thoroughly by earnings.

Emphasis was placed on the rearrangement and expansion of petrochemical operations in the second half, at which time an upturn started to occur in that sector. A restructuring of our shareholdings in Husky Oil Ltd. was negotiated in the fourth quarter to bring in a strong investor group as partner in that company. This transaction continued improvement of NOVA's balance sheet.

Optimism in the stock markets has moved our common share price up considerably in the first four months of 1987. We believe this signifies a rediscovery by investors of the cost-efficient and extremely competitive gas-based production and service industry in western Canada and NOVA's leading role in this industry.

In particular, the outlook for ethylene and polyethylene markets is becoming more positive. NOVA has become the national leader in production of these commodities with its world-scale plant operations.

Earnings per common share in 1987 are expected to improve over 1985 and 1986 because of better operating margins in Novacor Chemicals Ltd. and reduced development expenses in NovAtel Communications Ltd.

Better polyethylene prices and change of ownership in Husky are expected to improve results in 1987.

A number of good refinancing opportunities are being taken in 1987, and other new actions are planned to move the Company forward.

Financial Overview

The financial performance of the Company in 1986 was about on budget, with income before unusual and extraordinary items of $138.1 million, equivalent to earnings per common share of 40 cents. This was achieved in part by some non-recurring transactions that helped to make up for some of the shortfall in operating performance.

Novacor's linear low-density polyethylene prices, after showing an improvement in late 1985, fell off again in 1986 with prices going as low as 22 cents U.S. per pound by mid-year. Those prices then started improving a little in the late fall of 1986, with a five-cent increase coming into effect in that period and a further three-cent increase this spring.

In manufacturing, our telecommunications affiliate, NovAtel, had hoped to contribute reasonable profits in 1986; however, product development expenses and a slow start on a new product line once again postponed financial success.

As of December 1, 1986, the Company ceased to consolidate the accounts of Husky and commenced to account for that investment by the equity method for the retained 24.4% interest. This has resulted in large changes to our assets, liabilities and other balance sheet and income figures as compared with 1985.

The Company recorded unusual items during 1986 resulting from actions within affiliated companies which reduced income by $30.1 million or 22 cents per common share. In December, Husky reduced the carrying value of certain of its Canadian frontier and international oil and gas properties and recorded a loss on the sale of a semi-submersible drilling rig. NOVA's share of these Husky write-downs was $23.1 million. In addition, as reported in the third quarter, a loss was incurred by another affiliate on the sale of its interest in a methanol plant in New Zealand. Our share of this loss was $7.0 million.

As a consequence of the above unusual items, consolidated income before extraordinary items was $108.0 million or 18 cents per common share on a total of 134.7 million average common shares outstanding. Fully diluted earnings per common share before extraordinary items were 17 cents.

The extraordinary item recorded for 1986 relates to the decision made in December to sell a portion of our ownership in Husky, reducing our investment in that company from 56.7% to 24.4%. The Company decided to record in 1986

some expenses anticipated in 1987 for the portion sold, which offset a small gain on sale and produced a net extraordinary loss of $7.8 million. The cash proceeds received from the completion of this transaction on May 1, 1987, are shown on the balance sheet as at December 31, 1986, as an asset held for sale. The $7.8 million extraordinary loss decreased final net income for 1986 to $100.2 million. Earnings per common share after this extraordinary item were 12 cents basic and fully diluted.

Consolidated operating revenues for 1986 amounted to $2.7 billion, down from $3.3 billion in 1985 due to lower volumes of natural gas marketed to the U.S. and lower energy prices.

Total consolidated assets decreased to $4.8 billion in 1986 from $6.2 billion in 1985, primarily due to the deconsolidation of Husky during December.

Joint Control of Husky

NOVA acquired control of Husky in 1979 and with Husky's management took steps to strengthen that company as a leading independent Canadian oil company. Husky's head office was moved to Canada and investment in petroleum lands and exploration increased strongly in each of Alberta, Saskatchewan, the East Coast and Beaufort Canada Lands. Oil production increased similarly in Saskatchewan and Alberta. The period 1979 through 1986 saw Husky's operations in Canada strengthening steadily, and there was considerable improvement in its balance sheet after the sale of its United States properties.

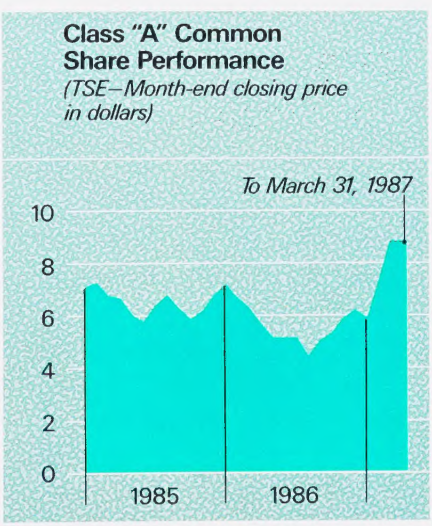
However, by 1986 NOVA's management had come to the view that continuing 57% ownership in this very aggressive, medium-size independent was not being reflected well in NOVA's share price and that there were other good reasons to restructure our investment in Husky.

After review of every attractive alternative, a proposal was developed in December 1986 to reorganize Husky and, following approval by Husky's shareholders in late April of 1987, this transaction was completed. As a result of an amalgamation and related transactions, Husky has been reorganized into a private company governed by a shareholders agreement with ownership control jointly by NOVA (controlling 43%) and two publicly traded Hong Kong companies, Hutchison Whampoa Limited and Hongkong Electric Holdings Limited (together controlling 43%). NOVA has named eight directors to the Husky Board. The Hong Kong partners have named a total of seven directors, including an officer of the Canadian Imperial Bank of Commerce which owns 5% of Husky.

Two other directors have been named pursuant to the shareholders agreement. One is a Canadian investor who owns the remaining 9% of Husky and is a son of Mr. Li Ka-shing, the Chairman of Hutchison. The other is the continuing President and Chief Executive Officer of Husky.

As a result of the reorganization, NOVA feels satisfied that Husky's future as a Canadian integrated oil company has been considerably enhanced by the introduction of a financially strong and successful partner group. NOVA has preserved a position of essential equality in control of Husky and the new partner grouping is committed to

The share price and trading volumes for NOVA Class "A" common shares increased significantly in the first three months of 1987.



investment in Husky's continuing growth as a Canadian unit.

From this transaction, NOVA received cash proceeds of approximately $359.0 million in May 1987 and has removed $234.3 million of Husky's debt from its consolidated balance sheet as at December 31, 1986.

A further result of the reorganization is that an indirect interest in Husky of about 18%, which is part of the 43% block controlled by NOVA, is held by a third party on an interim basis. NOVA has the option to purchase this interest at any time prior to the end of April 1988. During the subsequent three-month period after April 1988, NOVA can be obliged to purchase any part of this interest not previously purchased by other parties. It is our intention to arrange the placing of the entire interest with other parties prior to April, 1988.

While share values in oil and gas companies have been on the rise in early 1987, we believe this restructuring of Husky with the introduction of new capital will prove to be a good deal and timely for future investment and income opportunities.

Renewed Favour in Petrochemicals

It is a great pleasure to report new optimism on the future prospects for polyethylene. Since our large plant at Joffre started operation in 1985, we have encountered low polyethylene commodity prices, even though market demand remained relatively strong. However, we appear now to have worked through the worst of that situation and may finally be looking at the long-intended upside in this business.

As reported earlier, the last six months have seen two meaningful price increases in polyethylene and increasing demand particularly for linear low-density product. With no significant new capacity coming on stream, every indication now is that the higher price trend will continue.

Putting aside the question of price, other good things have occurred in our polyethylene business in the last year.

Improvements were made in the plant's technical and operating performance, capacity was expanded by over 25% at very little capital cost, and a pelletizing unit is in the process of completion which will give us a premium product in the market while lowering shipping and additive costs. In addition, our petrochemical management was able to reach agreement with its ethane suppliers for new contracts that reduced natural gas feedstock costs by about 20%.

In the process of looking at how we could rationalize and improve our petrochemical business throughout 1986, it was decided the best approach was to expand our product lines and position in the marketplace. In that respect, in late December agreement was reached for purchase of a plant owned by Union Carbide Canada Ltd., located in Moore Township near Sarnia, Ontario. The plant is capable of producing high-pressure and high-density polyethylene and linear low-density polyethylene. When combined with our Joffre output, NOVA is now the largest manufacturer and marketer of polyethylene products in Canada.

The Company's two ethylene plants at Joffre, operated by a wholly owned subsidiary and having a combined capacity of 2.7 billion pounds per year, continued to produce at capacity. With the expansion of the Joffre polyethylene plant, the acquisition of the Moore facility and increased demand for ethylene from cost-of-service customers, there is some concern about the adequacy of ethylene supply in the future. Therefore, plans have been reactivated for a third ethylene plant in Joffre. An industrial development permit for this plant was granted in 1980 by the Alberta Energy Resources Conservation Board; however, the project was put on hold due to price uncertainties and the major restructuring which was occurring within the petrochemical industry worldwide.

This third ethylene plant will be designed to have a production capacity of 1.5 billion pounds per year and targeted start-up will be late in 1991. Commencement of construction will be subject to the remaining government approvals and the arranging of satisfactory contracts for the sale of plant production.

Share Price Begins Recovery

As noted earlier in this report, the price of NOVA's Class "A" common shares has been climbing since the beginning of 1987 and trading has been extremely active. The best market intelligence we have been able to obtain tells us the strength is based primarily on optimism about the future of polyethylene combined with a favourable impression in respect to the Husky joint control transaction. It appears to be well understood by existing shareholders and new buyers that a real upturn in earnings, based on better petrochemical results, will not have full effect until 1988 and beyond, but professional advisors on the stock market are once again beginning

to look positively at future earnings and growth potential rather than just current quarter-by-quarter results. This is good news for NOVA's shareholders, who have been so patient over an extended period.

Directors and Management

Mr. R.H. Carlyle, formerly President of Gulf Canada Resources Inc., and Mr. William Comrie, Chairman of the Board of The Brick Warehouse, joined the Board at the 1986 annual meeting. Mr. Ronald Southern resigned from the Board in August, 1986.

Several changes in officer positions were also made in 1986.

- Mr. James H. Butler joined us in May of 1986 as Chairman and Chief Executive Officer of Novacor Chemicals Ltd., the subsidiary company that is responsible for all of NOVA's petrochemical investments. In 1987 Jim Butler was also appointed as an Executive Vice President of NOVA. Prior to joining NOVA, he was employed with a major oil company in the international operations of their petrochemical division.
- Late in the year, Mr. William G. Wilson joined the Company as Executive Vice President with general management responsibilities to which the position of Chief Financial Officer was added in 1987. Bill Wilson was most recently President of Cominco Ltd., Vancouver, and prior to joining Cominco was a partner in the accounting firm of Clarkson Gordon.
- On May 15, 1987, Senior Vice President Dianne Hall will leave the Company to move to new career opportunities. Ms. Hall joined NOVA in 1972 and was a key member of the team that took this Company through its very active growth years.
- At the end of 1986, William C. Rankin retired from all assignments, including a Senior Vice President position in the Company and the Chairman position in our affiliate, NovAtel Communications.

1986 was another year of hard work under difficult conditions. Many people deserve special recognition and we'd like to particularly commend the management and staff of our petrochemical division.

NOVA financial officers and staff performed well for us throughout the year including during the demanding period of the Husky negotiation. Husky management and staff, as well as the Special Committee of its Board that acted on behalf of minority shareholders, deserve our thanks and congratulations for a job well done.

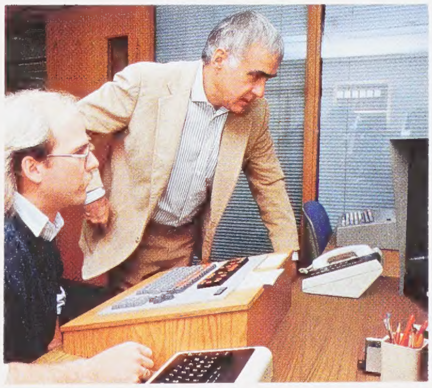
To all NOVA employees, the directors recognize your diligent and loyal efforts and take this opportunity to publicly acknowledge them.

Respectfully submitted on behalf of the Board of Directors,

S.R. Blair
Chairman and Chief Executive Officer

R.L. Pierce
President

May 1, 1987



Robert Blair reviews procedures at the gas control centre in Edmonton; at head office in Calgary, Robert Pierce talks with a customer.

GAS TRANSPORTATION & MARKETING

Total gas volumes declined slightly in 1986, but new pricing policies should encourage market growth in 1987.

Investments in natural gas transportation and marketing include the 100%-owned gas gathering and transmission system in Alberta, and 50% ownership of Foothills Pipe Lines (Yukon) Ltd. and Trans Québec & Maritimes Pipeline Inc.

In addition, NOVA owns 50.005% of Pan-Alberta Gas Ltd., a major marketer of natural gas in Canada and the United States.

Gas Receipts Down Slightly from Record Level

Despite a modest increase in demand for natural gas within Canada, lower sales to the U.S. midwest and California markets led to a decline of 5% in total volumes transported by the Alberta Gas Transmission Division during 1986, compared with record deliveries in 1985.

For 1987, however, newly deregulated Canadian pricing policies are expected to encourage long-term market growth.

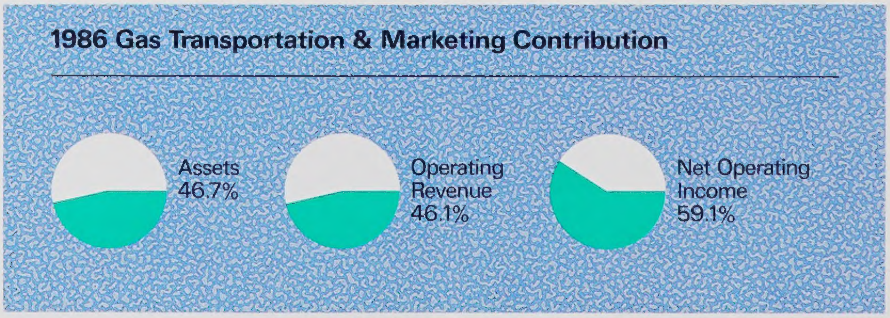
Our Alberta system transported 2.13 trillion cubic feet within the province in 1986, compared with a record 2.25 trillion cubic feet in 1985. Daily volumes reached a peak of 8.07 billion cubic feet on January 7, 1986. Some 1.67 trillion cubic feet were exported from Alberta, including 357.6 billion cubic feet destined for California and 89.7 billion cubic feet delivered to the U.S. midwest via the Foothills pipeline system. Daily export volumes reached a peak of 6.73 billion cubic feet.

Deliveries within Alberta totalled 460 billion cubic feet, up 11.2% over 1985 volumes of 413.6 billion cubic feet. Daily deliveries remained high throughout the year, due primarily to use by the provincial petrochemical industry, the largest growth market for Alberta gas in recent years.

Transportation service rates averaged 24 cents per thousand cubic feet in 1986 and 1985. Despite lower total throughput, rates were maintained through ongoing cost control efforts of the Alberta Gas Transmission Division. The NOVA average postage stamp rate charged on exports from the province was 27 cents per thousand cubic feet and charges for service within the province were lower than the export service rate.

At December 31, 1986, NOVA's system comprised 8,745 miles of pipeline, 38 compressor station sites with a combined compression rating of 544,677 horsepower, and 774 receipt and major delivery points.

On June 1, 1986, NOVA reduced its rate of return on rate base to 12.91% from 13.67% in recognition of the industry downturn, general reduction in the cost of capital and



specific refinancing arrangements for certain long-term debt issues. The new rate, which incorporates a 13.5% after-tax return on a deemed 32% common equity, was set after discussions initiated by NOVA with customers, Alberta gas producers and other groups.

Deregulation Prompts Rate/Tariff Changes

As a result of gas deregulation in Canada on November 1, 1986, NOVA has adopted a two-part demand/commodity rate to recover transmission costs for gas destined for markets outside the province.

Since 1980, export gas transmission costs have been recovered on a commodity basis that provided a single monthly unit cost linked to actual usage of the pipeline. The new system requires customers to contract for maximum daily volumes. The demand charge is based on these volumes, regardless of throughput, and the commodity charge is based on actual throughput.

Since a customer's unit cost for transporting gas will vary according to that customer's actual deliveries versus contracted volumes, the new system provides an incentive for the most economic and efficient use of pipeline facilities in the deregulated environment.

The change to a demand/commodity system has no financial impact on NOVA. There has been a substantial increase in customers and contracts, resulting in an increased workload for NOVA's gas transmission division, particularly in areas such as system planning, gas control, measurement, and rates and contract administration.

System Improvements Highlight Pipeline Construction Activity

NOVA's pipeline programs focused primarily on improvements to the existing pipeline system in 1986. Capital spending of $75.6 million was lower than recent historical levels.

Two compressor stations, at

Pelican Lake and Buffalo Creek in the northeastern part of the province, were completed and commissioned.

These stations are remotely controlled from Edmonton and visited weekly by operations personnel. They are accessible only by helicopter during the summer and by a winter road when the ground is frozen.

The Company also built 33 meter stations and made modifications to an additional 97 meter stations. Approximately 186 miles of pipeline were installed at various locations around the province.

This year, capital spending is budgeted at about $80 million. The system will be expanded by adding compression and building lateral pipelines provided customer requests indicate additional capacity is needed.

NOVA continues to improve system efficiency and safety by applying the latest technology to its state-of-the-art pipeline system, including the installation of mechanical dry seals and active magnetic bearings in compressors, which improves safety, efficiency and reliability.

In addition, NOVA is using innovative electronic techniques to conduct internal analyses of its pipelines. These new methods are less costly than conventional testing techniques. They provide accurate information without taking a facility out of service, as well as improving systems for predicting pipeline maintenance requirements.

Deregulation of the Canadian gas industry places more demands on NOVA's gas pipeline operations as new customers and contracts are added to the system.

As a result, the Company is analysing and upgrading its information processing systems so that we can meet the requirement for services in this challenging new environment.

In 1986, completion of the first phase of this analysis resulted in an expanded capacity for gas control handling and data collection. This phase also allowed for the establishment of computer capability for district offices to provide back-up for NOVA's main operations control centre in Edmonton.

Maximum Use of Phase I Pipeline Tops Foothills Agenda

Phase I of the Alaska Gas Highway Pipeline system, operated by Foothills Pipe Lines (Yukon) Ltd., is well positioned to benefit from increased sales of Canadian gas to the United States.

In 1986, the western leg operated at its capacity of 240 million cubic feet a day; the eastern leg, with contracted capacity of 975 million cubic feet a day, operated at about 25% of load factor.

The optimum design capacity of the eastern leg is about 1.8 billion cubic feet a day and the system could be expanded to this level through the addition of compression facilities at much less cost than building new pipeline facilities. As a result, Foothills is continuing to seek maximum use of existing capacity and to evaluate ways and means of expanding the eastern leg to serve potentially large new markets in the midwest and northeast areas of the United States.

The pipeline was built as the first phase of a major new pipeline system designed to bring Alaskan

Workers at the Airdrie Service Centre in southern Alberta use their technical skills and specialized equipment to keep gas transmission equipment operating efficiently.

gas to market in the United States as other gas supplies are depleted. Foothills remains committed to the completion of this project.

At the end of 1986, the eastern and western legs comprised 528 miles of pipeline, four compressor stations with a combined compression rating of about 142,000 horsepower and two meter stations. The rate of return during the year, determined on an average rate base of $673.3 million, was 12.1%.

TQM Expects Stable Market

Total gas volumes transported through the Trans Québec & Maritimes Pipeline (TQM) increased by 7% in 1986 to about 90 billion cubic feet from a 1985 level of about 85 billion cubic feet. TQM transports gas to residential, commercial and industrial customers in Quebec. This year, volumes are expected to increase slightly from 1986 levels.

In the fall of 1986, the National Energy Board set a monthly toll on the TQM system at $6.8 million and authorized a 12.94% rate of return on a rate base of $412.2 million, with a 13.5% after-tax return to a 25% equity component.

TQM facilities comprise 213 miles of pipeline, 10 meter stations and five sales taps.

Pan-Alberta Sales to California at 100% of Contract

For the second year in a row, customers in California purchased all of the natural gas allowed under their contract with Pan-Alberta Gas Ltd., NOVA's gas marketing affiliate.

About 85% of Pan-Alberta's sales are made to U.S. buyers. Gas exports are under severe pricing pressure and competition for sales is fierce as the United States works through a current surplus of domestic supply. Pan-Alberta had total sales of 219 billion cubic feet in 1986, compared with 260 billion cubic feet in 1985. Although total industry gas sales are not likely to grow significantly this year, Pan-Alberta expects to increase its share of the market through aggressive marketing techniques.

As a result of the deregulation of natural gas prices in Canada, Pan-Alberta renegotiated its approximately 1,200 contracts with 420 Alberta producers for gas supplies. In October, Pan-Alberta announced the successful renegotiation of several export contracts.

Export contracts with Northern Natural Gas Company, Panhandle Eastern Pipeline Company and Westcoast Transmission Company Limited are all long-term contracts that provide for periodic negotiation of essential terms.

The long-term contract with Pacific Interstate Transmission calls for delivery of 240 million cubic feet a day to California through the western leg of the Alaska Highway Gas Pipeline system.

Renegotiated terms for domestic sales to Gaz Metropolitain Inc. were effective October 1, 1986.

Pan-Alberta also reached a settlement, subject to regulatory approval, in a dispute with United Gas Pipe Line Company, its major customer, over gas volumes and prices under the contract. Under the terms of the two-year interim agreement, Pan-Alberta will receive lump sum cash payments and

transportation credits from United Gas plus a commodity price for gas contracted for delivery. The transportation credits will facilitate increased sales, especially if market conditions improve.

PETROLEUM

We continued to develop new oil and gas ventures in 1986 as the industry adapted to new energy economics linked to lower prices for oil.

NOVA's petroleum activities are carried out through wholly owned Novalta Resources Ltd. and the Company's investment in Husky Oil Ltd. Husky is a major Canadian integrated oil company involved in exploration, development, production, refining, marketing and distribution. Novalta Resources is engaged in oil and gas exploration and production. Its activities are centred in Alberta.

Partial Sale of Husky

Late in 1986, NOVA entered into an agreement to reorganize its shareholding in Husky from a 57% control block to a 57% ownership and control position in a 43% principal shareholding block.

The reorganization of Husky, on approval of its minority shareholders, resulted in Husky going private, having two principal shareholding blocks with the main corporations involved being Hutchison Whampoa Limited of Hong Kong and NOVA. As a private company, Husky will no longer report to the general public on financial performance or be listed on the stock exchanges.

Full details of the transaction are available in Husky's Information Circular and Proxy Statement dated March 24, 1987. This material was mailed to the minority shareholders of Husky in late March.

Husky Profitable Despite Industry Downturn

A strong downstream sector, reduced royalties and taxes, and lower net interest expense helped offset the negative impact of substantially lower oil prices on Husky's earnings in 1986.

Earnings before unusual items were $131.1 million, compared with $126.0 million in 1985. Unusual items totalling $94.7 million after taxes were recorded during the year, consisting of write-downs of Canadian frontier and international oil and gas exploration programs and also a loss on the sale of a semi-submersible drilling rig.

After these unusual items, Husky's net earnings were $36.4 million in 1986, compared with $126.0 million in 1985. Revenue declined to $637.7 million from $923.3 million in 1985. Cash flow from operations was $287.1 million, down about 12% from 1985. Net capital expenditures totalled $191.4 million, compared with $268.9 million in 1985.

Petroleum and gas revenue tax and royalty exemptions and recoveries resulting from an agree-

ment between Husky and the governments of Canada, Alberta and Saskatchewan totalled $49.5 million in 1986.

Income tax expense for the year was reduced by $25.8 million as a result of applying losses for tax purposes to recover income taxes paid in prior years.

Gross production of light and medium crude oil and natural gas liquids averaged 12,500 barrels a day in 1986, down about 6% from 1985. Heavy oil production decreased 5% to an average of 29,500 barrels a day, including about 7,500 barrels per day from enhanced oil recovery projects. Natural gas sales averaged 59.6 million cubic feet a day, down 5% from 1985 levels.

Husky participated in 31 exploration wells and 147 development wells drilled in provincial areas last year, resulting in 125 oil and 24 gas wells. About two-thirds of this exploration and development drilling activity was conducted in Alberta.

In the frontiers, Husky participated in ongoing delineation drilling and testing of the Amauligak oil field in the Beaufort Sea. During tests, the Amauligak I-65B well produced up to 16,000 barrels a day and potential reserves for the structure are currently estimated to be in the range of 500 - 800 million barrels of recoverable oil. On the East Coast, Husky's drilling activity included five wells in the Grand Banks area and three wells on the Scotian Shelf. The East Coast drilling program resulted in one oil discovery and three natural gas finds. One well has yet to be tested. Three wells were dry and abandoned.

In the downstream sector, Husky's 1986 asphalt sales, which averaged 8,825 barrels a day, exceeded the strong performance recorded in 1985. Sales of blended crude oil decreased about 10% from 1985 to average approximately 85,650 barrels per day.

Husky's two refineries, located at Lloydminster, Alberta, and Prince George, British Columbia, averaged daily throughputs of approximately 16,400 and 7,900 barrels, respectively, in each case representing an increase over 1985 levels.

The profit contribution of the downstream sector substantially exceeded the good performance attained in 1985.

Novalta Resources Plans to Increase Natural Gas Sales

Novalta Resources Ltd., a wholly owned oil and gas company, continued to show an operating profit in 1986 despite generally poor industry conditions.

Consistently successful since its formation in the mid-1970s, Novalta drilled 23 gross (12 net) wells in 1986, which resulted in 10 gross (4 net) oil discoveries and 9 gross (6 net) gas discoveries.

Gas production averaged 32 million cubic feet per day, compared with 35 million cubic feet per day in 1985. Oil production averaged 692 barrels per day, compared with 453 barrels per day in 1985. Novalta's landholdings total 1.2 million gross (600,000 net) acres.

This year, Novalta gas production will increase as the company supplies additional fuel gas to NOVA's petrochemical facilities at Joffre, Alberta.

The fuel gas replaces hydrogen

Husky's refining and marketing sector made a major contribution to the solid performance of the petroleum division during 1986.

The high quality, full-service marketing operations continued to expand with growing consumer patronage.

that will be supplied to the nearby ammonia plant.

Novalta will continue to direct its exploratory efforts toward medium and long-term opportunities arising from activities of the NOVA group.

PETROCHEMICALS

Higher unit prices and sales volumes, plus reduced costs, are expected to produce a significant improvement from petrochemical investments in 1987.

NOVA's petrochemical assets, totalling $1.1 billion, are the responsibility of wholly owned Novacor Chemicals Ltd. They include facilities for the production of ethylene and polyethylene. Novacor also manages NOVA's investments in ethane extraction and gathering systems, product pipelines and storage facilities, and methanol production facilities at Medicine Hat, Alberta.

Plans Approved for Construction of Third Ethylene Plant

An improved supply/demand forecast for ethylene derivatives and reduced prices for feedstock have prompted the Company to reactivate plans for construction of a third ethylene plant at Joffre, Alberta.

An industrial development permit for this project was obtained in 1982 but construction was delayed pending improvements in petrochemical industry operating conditions.

Construction will begin once sales contracts for plant production are signed and remaining government approvals are received. The third plant will have ethylene production capacity of 1.5 billion pounds a year. It is expected to begin operation in late 1991.

Through 1986, NOVA's two existing ethylene plants, which provide ethylene to customers on a cost-of-service basis, continued to operate reliably and efficiently. Design capacity of the two existing plants is 2.7 billion pounds of ethylene a year.

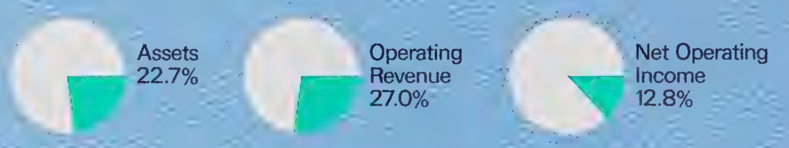
The cost of natural gas used for petrochemical feedstock is expected to decline by about 20% this year from 1986 levels because of new contracts signed late in 1986 with gas shippers and producers.

Reduced gas costs have a direct impact on Novacor's cost of manufacturing linear low-density polyethylene because ethane feedstock is extracted from gas and used to produce ethylene. The ethylene is then upgraded to manufacture a range of petrochemical commodities, including polyethylene.

The new contracts, restructured to reflect prevailing industrial gas prices, were signed after a year of ongoing negotiations with Alberta producers.

In the past, provincial legislation required the petrochemical industry to buy gas at the Alberta border price for exports.

1986 Petrochemicals Contribution



Major Improvement in Polyethylene Operations Forecast for this Year

NOVA's polyethylene operations are expected to reflect a significant improvement in operating results over the next two years as a series of business and technology-related decisions taken in 1986 continue to be implemented.

In addition, polyethylene prices strengthened in the fourth quarter and in early 1987, and there is a general expectation of additional price improvement this year as worldwide demand increases at a modest rate and production capacity remains essentially flat.

The main features contributing to an improved outlook for NOVA's polyethylene business are reductions in natural gas feedstock prices under restructured contracts and significant expansion of plant capacity. The installation of new equipment and some restructuring of administrative functions will complete the cost reduction program.

The linear low-density polyethylene plant, originally designed for annual production of 600 million pounds of polyethylene resin, averaged 95% of capacity throughout 1986. This year, technological improvements will increase design capacity by about 25% and the plant is expected to produce at least 700 million pounds of polyethylene. The plant has achieved a current design capacity of 750 million pounds.

In addition, several steps have been taken to open new markets by expanding the range of Novacor's polyethylene products.

In February 1987, NOVA purchased the Union Carbide Canada Ltd. polyethylene plant in Moore Township, located near Sarnia, Ontario. The plant was designed to produce 230 million pounds per year of high-density polyethylene and 200 million pounds per year of low-density polyethylene. The acquisition gives NOVA about 45% of total Canadian polyethylene production capability and provides the Company with a full line of polyethylene resins

to market in Canada.

Operations will be enhanced further this year by the installation of equipment that allows linear low-density polyethylene to be produced as pellets in addition to current granular output. Pelletizing produces a more uniform product that sells for a premium and can be shipped more cost effectively than granular resin.

Throughout 1986, Novacor maintained a commitment to providing good customer service by offering consistently high quality resins, maintaining reliable delivery schedules, and working with customers to improve product design and production procedures.

Hydrogen Project Completed on Time, under Budget

A new project to provide hydrogen to the owners of an ammonia plant built near the Company's petrochemical complex at Joffre, Alberta, was completed on schedule and under budget during the spring of 1987.

Hydrogen, used formerly for plant fuel at the ethylene plant site, is extracted from a reactor off-gas stream and piped to the ammonia plant. The replacement fuel gas is supplied by Novalta Resources, the oil and gas company wholly owned by NOVA.

The hydrogen project will provide an assured revenue stream that covers both the cost of capital and operating costs. It is expected to make a noticeable contribution to the petrochemical division net income this year.

Methanol Industry Remains Constricted by Depressed Prices

Depressed prices for methanol, due to severe oversupply around the world, continue to plague methanol producers.

As a result, Alberta Gas Chemicals cut production last year by 50% at its three methanol plants in Medicine Hat, Alberta, and sold its 49% interest in a New Zealand methanol plant.

The Medicine Hat plants have a combined design capacity of 2,400 short tons per day.

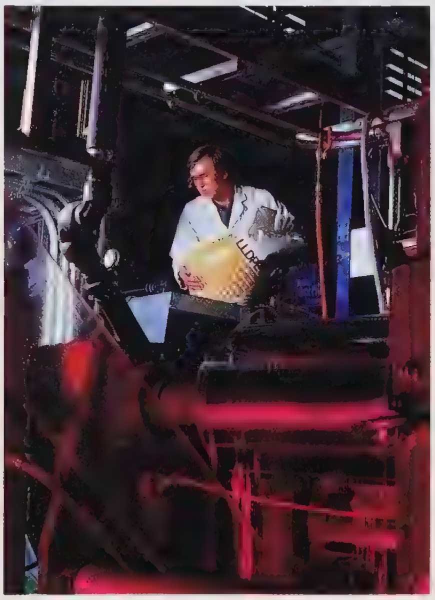
Two of the plants have been closed until the price of methanol recovers to a level sufficient to allow start-up.

The third and most efficient plant, with a design capacity of 1,200 short tons per day, continues to operate somewhat over design capacity. Production is sold primarily to customers in North America with some exports to Pacific Rim countries.

Meanwhile, Alberta Gas Chemicals is continuing to develop the market in Canada for a blend of unleaded gasoline and methanol as an alternative to regular unleaded gasoline. The product is offered for sale at 42 service stations in Ontario.

Methanol is established as a viable gasoline blending component in several countries, including West Germany, New Zealand and parts of the United States.

Alberta Gas Chemicals is also participating in experiments aimed at transporting methanol to Eastern Canada and the U.S. midwest through pipelines, a plan which has the potential to result in significant cost savings. An experimental delivery conducted in 1986 moved 4,200 metric tons of methanol over 1,900 miles in 42 days.



Injection moulding machinery allows NOVA's petrochemical technologists to research product flexibility of linear low-density polyethylene for a variety of commercial applications.

OTHER BUSINESSES

NOVA's international consulting subsidiary was awarded major engineering contracts in 1986. Valve operations continued to earn a profit despite weak markets.

In addition to its primary businesses, NOVA has interests in international consulting, telecommunications, manufacturing, and research and development.

Novacorp Wins Major Pipeline Contracts in Malaysia and Turkey

Novacorp International Consulting Ltd. (100% owned) provides engineering and technical expertise to clients around the world, particularly in pipeline transmission systems.

Late in 1986, Novacorp, in conjunction with a Malaysian company and through its subsidiary, Novacorp (Malaysia) SDN BHD, was awarded two contracts worth $40 million. The contracts are for project management and operations and maintenance consultancy for Stage II of Malaysia's Peninsular Gas Utilisation Project.

Under the terms of the contracts, Novacorp will provide basic engineering and supervision of all engineering, procurement, construction and commissioning as well as management, operations and maintenance of a 453-mile pipeline system.

Up to 30 Canadian engineers and project management experts will be resident in Malaysia during various phases of the contracts.

Novacorp provided engineering and consulting services on the first phase of the project which was completed in 1984. For this second phase, Novacorp was the successful bidder after an extensive evaluation of proposals submitted by several international competitors.

In Turkey, Novacorp was awarded a $3.5 million consulting services contract to monitor engineering design, materials procurement, construction and commissioning of the U.S.S.R.-Turkey natural gas pipeline project. The project includes construction of 523 miles of gas pipelines both onshore and offshore, one compressor station and 10 metering stations.

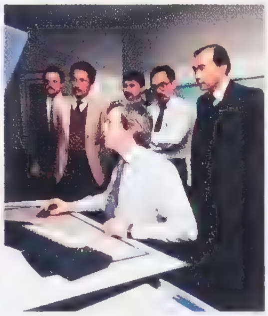
A task force of about 21 Novacorp specialists will be assigned to offices in Ankara and Istanbul for up to 18 months.

In 1986, Novacorp won assignments in 18 countries and is bidding and negotiating on other major engineering projects. Work is currently under way in several countries including China, Australia, Finland and Venezuela.

Telecommunications Affiliate Gears Up Marketing Efforts

Sales by NovAtel Communications Ltd. (50% owned) more than doubled in 1986, moving NovAtel up two notches to second place in the large United States terminals market.

A Novacorp executive talks with colleagues in Kuala Lumpur. Last year, major contracts were awarded for ongoing pipeline construction projects in Malaysia and Turkey.



Novacorp tailors its engineering training programs in Canada and host countries to meet specific needs of customers.

About 65% of total 1986 sales were made in U.S. markets. Continued growth is projected for these markets in 1987, but the percentage of the total is expected to fall to about 57% as domestic and other international markets begin to mature and register higher sales.

These include major areas where NovAtel established new and stronger footholds in 1986, including the United Kingdom, China, Australia and New Zealand.

Overall NovAtel expects to again double sales in 1987, in part through distribution and supply agreements already under contract.

In February 1987, NovAtel announced the sale of its first United States cellular system in the Shreveport-Bossier City area of Louisiana. The system serves as an operating model for several additional systems to be installed in the United States.

NovAtel has been awarded contracts for three systems in Michigan, expected to be in operation this year, and plans are under way to install NovAtel systems in Wisconsin and Arkansas.

Other mobile telephone systems designed by NovAtel are being installed at several locations in western Canada, the Northwest Territories, and in the city of Chongqing, China.

NovAtel designs, manufactures and markets a wide range of cellular systems and telephones.

Formed in 1983, it has grown rapidly despite strong competition from established international telecommunications companies.

NovAtel is headquartered in Calgary and has offices in Vancouver, Edmonton, Toronto, Montreal, the United States and the United Kingdom. Manufacturing facilities are located in Lethbridge, Alberta.

Profitable Valve Group Leads Manufacturing Operations

Grove Italia S.p.A., NOVA's wholly owned manufacturer of pipeline valves and flow control products, continued to buck industry trends in 1986 by earning a profit despite deteriorating markets worldwide.

In an industry where virtually every major participant lost money last year, the valve group had a profit of $9.3 million.

Grove Italia S.p.A. has been consistently profitable since its formation in 1970. A recent survey of manufacturing companies in Italy conducted by a major financial newspaper rated the company first by operating income, seventh by net income and 41st by revenue in 1985.

In the United States, Grove Valve and Regulator Company posted a small profit after three years of operating losses due to the dramatic slump in energy-related manufacturing business in North America.

A transaction to place the U.S. company under the management of the Italian company to improve market penetration and operating efficiency was completed in 1986.

Western Star Trucks Inc. (50% owned) continued to perform steadily in 1986 in the manufacture and sale of heavy duty trucks for North American and international markets. All markets continued to be very competitive and steep discounting held margins at a thin level.

At a total of about 2,500 trucks, Western Star's unit sales were near the 1985 level and that company

Technicians at NovAtel design and manufacture a full range of cellular systems and telephones that are marketed throughout North America and around the world.

continued to be profitable.

In 1986, it was determined that Western Star no longer fitted the long-term objectives of its shareholders and it was offered for sale through an investment banking firm in the United States. Discussions are ongoing with prospective purchasers.

CNG Fuel Systems (50% owned) markets conversion kits for vehicles that allow the use of natural gas as an alternative to gasoline.

In 1986, more than 3,200 vehicles were converted and 19 refuelling stations were sold.

The conversion business has declined due to lower world prices for oil and the resulting downward pressure on the cost of gasoline. In response to the downswing, CNG Fuels has consolidated its operations and reduced staff and facilities.

In addition to the efforts of CNG Fuels to increase the use of compressed natural gas, Novacorp Pressure Transport Ltd. (50% owned) is using trucks and specially designed trailers to provide compressed natural gas fuel to the heavy oil and asphalt paving industries and to rural gas cooperatives.

New Asphalt Product Proves Successful in Road Testing

A new type of polymer-modified asphalt has been developed by NOVA/Husky Research Corporation that withstands changing weather conditions and heavy traffic more successfully than other asphalt products.

Asphalt is widely used for road construction. However, conventional asphalt reacts dramatically to changes in temperature, becoming brittle in winter and soft in summer. Polymer-modified asphalt is significantly less susceptible to temperature changes.

The modified asphalt was applied to road surfaces in several areas of Alberta during 1986 and the test results indicate roads need less maintenance when treated with the new product.

Research is continuing on other uses for the new product.

NOVA/Husky Research was formed in 1981 to pursue research and development for both companies and their affiliates. Research focuses on petroleum, petrochemical and pipeline technology.

Particular areas of interest include heavy oil upgrading and enhanced recovery, gas dynamics, corrosion in pipeline systems, and polyethylene catalysis.

At present, NOVA/Husky is conducting 87 research projects for NOVA and Husky affiliates. This year, three patents will be sought in the areas of pipeline equipment and instrumentation, and environmental containment.

Last year was the first full year of operation for the NOVA gas dynamics test facility, developed jointly by NOVA/Husky Research and the Alberta Gas Transmission Division. The full-scale facility is used for a variety of research, product testing and training purposes.

Research at the facility has been focused on natural gas flow rate measurement and suppression of pressure pulsations.

NOVA/Husky Research is seeking better ways to detect pressure surges in pipeline systems and to extend the range of operation for compressor systems. The research program involves theoretical studies in the laboratory and field work at the test facility.

NOVA Shares Widely Held, Actively Traded on Canadian Exchanges

NOVA is one of a very few widely held Canadian companies and its Class "A" common shares are consistently among the most actively traded securities on Canadian stock exchanges.

In 1986, NOVA common shares were the second most active security traded on the Toronto Stock Exchange. More than 71.5 million shares were traded, representing a total dollar value of about $392 million.

At December 31, 1986, a total of 141.8 million Class "A" common shares were held in about 35,800 shareholder accounts.

- About two-thirds of the shareholder accounts are registered to individuals who hold 500 or fewer shares.
- In addition, NOVA shares are common in the portfolios of most Canadian institutions, including trust companies, pension funds, brokerage firms and banks.

NOVA also had 11 preferred share issues outstanding at December 31, 1986, totalling over 32.9 million shares held in about 32,200 shareholder accounts.

Geographically, about 96% of both common and preferred shares were registered in Canada at year end.

More than 40% of NOVA's common shareholder accounts are registered in Alberta.

In addition, about two-thirds of total common shares outstanding are registered in Ontario, which reflects the number of institutional investors headquartered in that province.

The Company's annual meeting will be held on Thursday, June 18, 1987, at 10:30 a.m. in the Palliser Hotel, 133 Ninth Avenue S.W., Calgary, Alberta.

Shareholders Benefit from Dividend Reinvestment Plan

Since it was implemented in 1982, NOVA's dividend reinvestment and share purchase plan has attracted total investment of about $95 million and increased the number of the Company's Class "A" common shares outstanding by some 16 million shares.

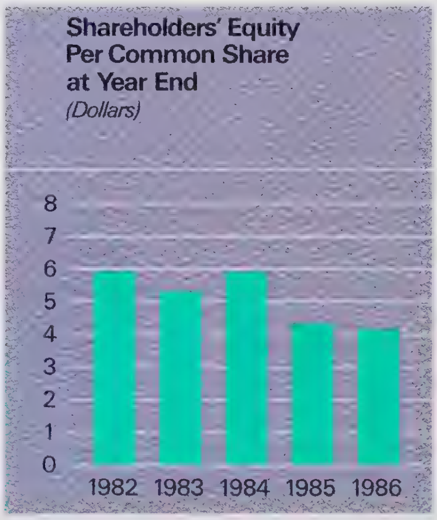
The plan provides a convenient method for shareholders to reinvest dividends automatically on all or some of their NOVA shares—both common and preferred—at 95% of the weighted average sale price of Class "A" common shares on dividend payment dates.

It also allows shareholders to make cash payments of $50 to $5,000 per quarter to buy common shares at 100% of the same average sales price.

Both options are offered to shareholders without brokerage or administrative fees attached. The plan is not available to residents of the United States.

Shareholders seeking additional information on the plan are invited to contact the transfer agent

Shareholders' equity per Class "A" common share remained stable in 1986 at just over $4 per share.



charged with its administration: National Trust Company, Corporate Trust Services, Suite 1008, 324 Eighth Avenue S.W., Calgary, Alberta, T2P 3B2. For shareholders not resident in Calgary, information may be obtained by calling the Company's toll-free number (800) 661-8686.

New share certificates for plan participants are issued upon written request. Beneficial shareholders wishing to obtain their share certificates should contact National Trust.

Requests for Information

NOVA welcomes questions from shareholders, and these may be directed to senior officers or to the treasury department by writing or telephoning the Company's head office. NOVA's toll-free number (800) 661-8686 may be used by Canadian callers residing outside of Calgary.

Literature on various aspects of the Company's business is also available and may be obtained by writing to our head office address or by calling our toll-free number.

Transfer Agents and Registrars

Class "A" common shares are registered with National Trust Company in Vancouver, Calgary, Edmonton, Regina, Winnipeg, Toronto and Montreal.

Class "B" common shares are registered with National Trust Company in Calgary.

The Company's preferred shares are registered as follows: The Canada Trust Company in Vancouver, Calgary, Edmonton, Regina, Winnipeg, Toronto and Montreal for all share issues, and The Canada Trust Company in Halifax (7.60%, 6⅜%, 6½%, 15%, 12%, 11.24% and 9⅛% preferred shares only).

The 1996 warrants are registered with Montreal Trust.

Stock Exchange Listings

NOVA's Class "A" common shares are listed on three Canadian exchanges: the Alberta Stock Exchange, The Montreal Exchange and The Toronto Stock Exchange.

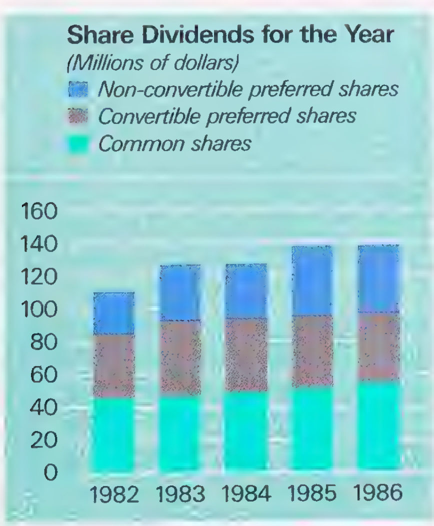
The Company's preferred shares are listed on the Alberta Stock Exchange, The Montreal Exchange (for 7.60%, 6⅜%, 6½%, 15%, 12%, 11.24% and 9⅛% preferred shares only) and The Toronto Stock Exchange.

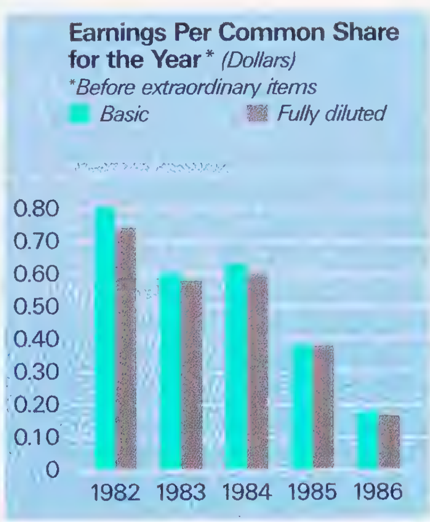
NOVA's various share issues are designated in newspaper listings as follows:

Nva AltA f	Class "A" Common
Nova C	4¾% Series C Preferred
Nova E	7¾% Preferred
Nova F	9¾% Preferred
Nova G	9.76% Preferred
Nova H	7.60% Preferred
Nova J	6⅜% Second Preferred
Nova K	6½% Convertible Second Preferred
Nova L	15% Preferred
Nova M	12% Convertible Second Preferred
Nova N	11.24% Preferred
Nova O	9⅛% Preferred
Nova W	1996 Warrants

Duplicate Annual Reports

Holders of NOVA securities may receive more than one copy of our annual and quarterly reports. Duplication can not always be avoided because our Class "A"





Dividends paid to shareholders remained at just under $140 million. Unusual items reduced earnings per share to 18 cents in 1986 from 38 cents per share in 1985.

common shares and preferred shares are registered with two separate transfer agents. Class "A" common shareholders who receive more than one communication due to some difference in registered name or address should contact National Trust Company to have their holdings consolidated. The holders of each distinct issue of preferred shares who are in the same situation should make similar arrangements with The Canada Trust Company.

Rapports Annuels en Français

Veuillez vous adresser au secrétaire de la Compagnie si vous désirez recevoir un exemplaire de la version française de ce rapport.

NOVA Supports Charitable Groups, Winter Olympics

Since we believe NOVA's ongoing program of corporate contributions to non-profit voluntary organizations across Canada is of special interest to shareholders, we have included an update on our 1986 activities.

Our major corporate contribution, which carries over from last year, is participation as a corporate sponsor of the XV Olympic Winter Games, a major international sporting event that will bring rich returns to all of Canada. The games will be held in Calgary in February 1988.

This sponsorship obligation is being met mainly through provision of goods and services, including secondment of several technical staff members to the groups responsible for organizing and managing the games. A major portion of the contribution to the games is allotment of space in NOVA facilities.

Total expenditure under the regular corporate contributions program was $750,000 in 1986, a 50% reduction from past years due to lower earnings and generally poor conditions in the energy and commodities businesses.

The contributions budget is established each year. Procedures and criteria that have been identified over the years are used as guidelines to allocate donations in five major areas: health and welfare, education, arts and culture, civic activities and recreation.

In 1986, our group of companies contributed $154,800 to 1986 United Way campaigns and employees donated an additional $147,005 for a total contribution of $301,805. We are proud of this generosity exhibited by our employees during difficult economic times in our industry and province.

Other health and welfare donations were made in support of various capital projects and the ongoing operations of local, provincial and national charitable organizations.

Donations were also made across Canada in support of several educational institutions and programs related to arts and culture.

In addition, NOVA entered into a "partnership" with one of the largest high schools in Calgary under a program established by the Calgary Board of Education.

The program, which fosters greater public involvement in education, is designed to enhance learning by providing additional resources in such areas as career counselling, business education, the arts, scientific research and library resource exchanges.

NOVA specialists have been seconded to the 1988 Olympic Winter Games as part of the Company's overall support as a corporate sponsor.

Overview

In 1986, the Company recorded annual consolidated income before unusual and extraordinary items of $138.1 million, equivalent to 40 cents per common share, up from $134.1 million or 38 cents per common share in 1985.

Unusual items recorded by affiliated companies reduced income by $30.1 million for the year. Consequently, consolidated income, after unusual items and before extraordinary items, was $108.0 million or 18 cents per common share.

An extraordinary loss of $7.8 million resulted in net consolidated income for 1986 of $100.2 million or 12 cents per common share, compared with net consolidated loss of $82.4 million or $1.31 per common share in 1985.

Revenue

Consolidated operating revenue was $2.681 billion compared with $3.347 billion in 1985, a decrease of $666.3 million or 20%.

Petroleum revenue was down $350.3 million, almost entirely due to the substantial decrease in oil prices in 1986. Petrochemicals revenue decreased $32.0 million from 1985. Improved prices and increased production in the polyethylene business were more than offset by reduced by-product sales from the Company's ethylene facilities together with reduced price and demand for ethane sales. Lower prices and reduced volumes of gas were the principal causes for the $292.5 million decrease in revenue in Gas Transportation & Marketing.

Improved operating performance in Petrochemicals helped to offset the effect of reduced energy prices in 1986.

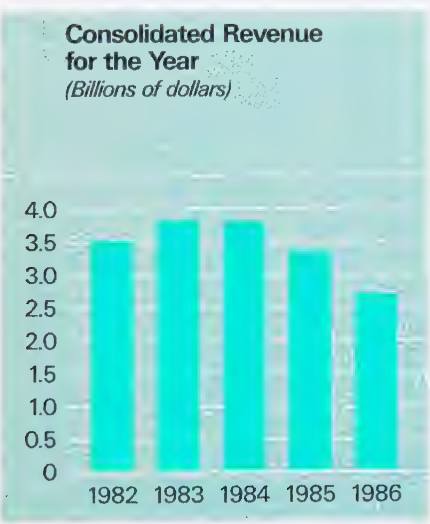
Costs and Expenses

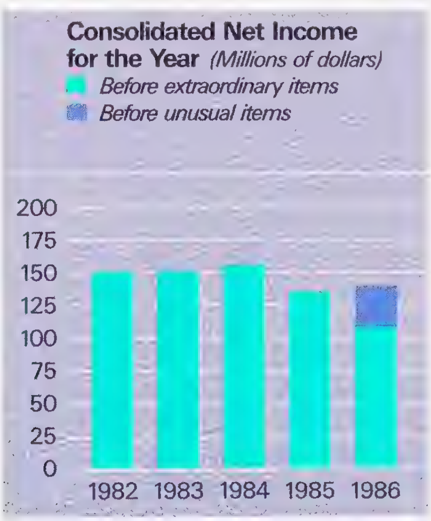
Total costs and expenses were $2.108 billion compared with $2.674 billion in 1985, a decrease of $565.9 million or 21%. Operating expenses were down $469.1 million through reduced gas purchases by Pan-Alberta, lower petrochemical feedstock costs and the effect of lower crude oil prices.

The decrease of $17.7 million in depreciation and depletion reflects lower depreciation in Petrochemicals, principally because of the reduced carrying value of the polyethylene plant.

Petroleum and gas revenue tax (PGRT) decreased by $78.5 million in 1986 due to the lower production volumes and selling price for crude oil.

In addition, an agreement was reached by Husky on April 8, 1986, with the Governments of Canada, Alberta and Saskatchewan concerning the Bi-Provincial Upgrader Project. The PGRT exemptions and recoveries resulting from this agreement were $36.0 million in 1986. The Government of Canada eliminated PGRT effective October 1, 1986.





Despite a 20% decline in revenue to $2.7 billion in 1986, consolidated income before unusual and extraordinary items increased to $138.1 million from $134.1 million in 1985.

Loss on foreign currency translation of $21.5 million was down slightly in 1986.

Most of these foreign exchange losses related to transactions involving U.S. dollar denominated debt within cost-of-service operations, which are recovered from customers, and to the amortization of unrealized foreign exchange losses on other monetary items. After allowing for minority interest, amounts billed under cost-of-service contracts and income taxes, this resulted in a loss of 5 cents per common share in 1986 as compared with 7 cents for 1985.

Net Operating Income

Net operating income was $573.2 million compared with $673.6 million in 1985. Improvements in Petrochemicals through better prices and increased production of polyethylene were more than offset by the effect of lower crude oil prices, lower rates of return and rate bases for certain Gas Transportation operations and a decline in contribution from valve manufacturing operations.

Other Items

The Company's share in losses of affiliated companies in Petrochemicals and Manufacturing was $17.6 million in 1986 as compared with $7.2 million in 1985. These companies are accounted for on an equity basis.

World methanol markets continued to be depressed while the demand for heavy trucks remained weak. The development of the Company's telecommunication investment continued to face stiff competition in the cellular telephone market while lower crude oil prices significantly affected the marketing of compressed natural gas conversion equipment.

The $2.4 million of equity earnings in the Petroleum sector in 1986 represents the Company's share of Husky's December results before unusual items and after giving effect to the decision by the Company on December 5, 1986, to sell 57% of its investment in Husky and maintain its remaining 24.4% interest as a long term investment.

The increase in other expenses during 1986 is principally due to the effect of the new lease expense, net of amortization of the deferred gain, relative to the sale/leaseback transaction on the Company's head office building completed in December 1985.

Interest

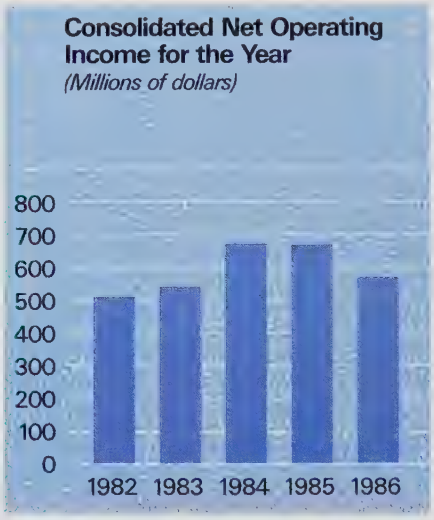
Net interest expense of $284.3 million, compared with $315.9 million in 1985, was down $31.6 million, principally due to a lower level of outstanding debt, partially the result of the proceeds received on the sale of the Company's head office building.

Income Taxes

Income tax expense of $61.6 million was down $94.3 million from 1985 principally as a result of lower earnings in petroleum operations.

In addition, income tax expense for 1986 was reduced by $34.8 million as a result of applying losses for tax purposes to income on which taxes had been previously paid or provided. This increased the Company's income, after minority interest, by $23.6 million.

Consolidated net operating income declined to $573.2 million in 1986 as improvements in petrochemical performance were offset by lower returns from oil, gas and valve manufacturing operations.



Minority Interest

Minority interest share of income of $63.2 million remains basically unchanged from 1985.

Net Income

In 1986, consolidated income before unusual and extraordinary items was $138.1 million, as compared with $134.1 million for 1985.

In 1986, the Company recorded its share of unusual items, net of applicable income taxes, incurred by affiliates accounted for by the equity method. In December, Husky recorded write-downs of certain Canadian frontier and international oil and gas properties together with a loss on the sale of a semi-submersible drilling ship. The Company's share of these items was $23.1 million. In the third quarter of 1986 a loss was incurred by Alberta Gas Chemicals on the sale of its interest in a New Zealand methanol plant of which the Company's share was $7.0 million.

Consolidated income before extraordinary items was $108.0 million, as compared with $134.1 million for 1985.

Basic earnings per common share for the year before extraordinary items were 18 cents on a total of 134.7 million average common shares outstanding, as compared with 38 cents on 128.1 million average common shares outstanding in 1985. Fully diluted earnings per common share before extraordinary items were 17 cents, as compared with 38 cents in 1985.

An extraordinary loss of $7.8 million in 1986, as compared with extraordinary losses of $216.5 million in 1985, resulted in net income of $100.2 million in 1986, as compared with a net loss of $82.4 million in 1985.

Earnings per common share after extraordinary items, both basic and fully diluted, were 12 cents, as compared with a loss per common share of $1.31 in 1985.

On December 5, 1986, the Company's Board of Directors approved an agreement whereby Husky would be restructured and NOVA would sell 57% of its 56.7% interest in Husky with the remainder to be held as a long term investment. For accounting purposes, effective December 1, 1986, the Company ceased to consolidate the accounts of Husky and commenced to account by the equity method for the retained 24.4% interest in Husky.

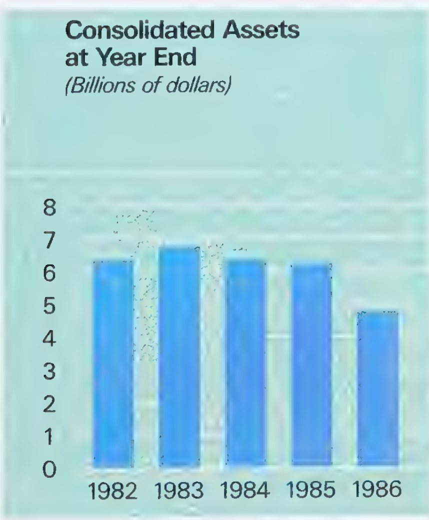
On April 22, 1987, the Husky minority shareholders approved the restructuring of Husky to form "New Husky". NOVA subsequently received approximately $359.0 million in cash and an indirect interest of approximately 97.8% in a New Husky preferred share issue, representing either an interest in certain frontier and heavy oil properties or a future cash payment.

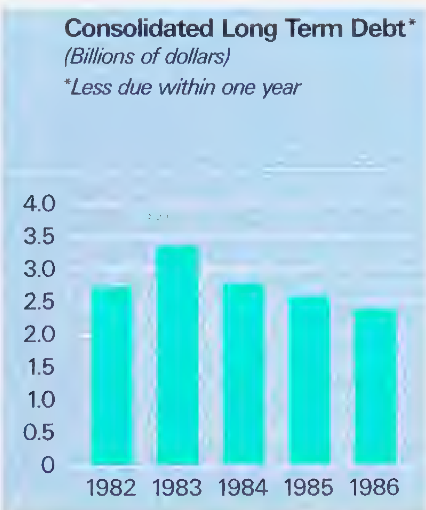
As a result of the Husky restructuring, the Company now holds an indirect beneficial interest of 24.4% in New Husky.

The portion of the Company's investment in Husky held for sale was written down to estimated net realizable value, and after providing for all estimated expenses relating to the transaction, the Company recorded an extraordinary loss of $7.8 million.

Extraordinary losses in 1985 comprised the following items:

- a non-cash deemed accounting loss of $58.9 million arising from





Deconsolidating Husky from NOVA accounts on December 1, 1986, reduced total assets to $4.8 billion from $6.2 billion in 1985. Long term debt was reduced to $2.4 billion from $2.6 billion.

the dilution of its ownership in Husky,
- write-downs of $157.4 million in the carrying value of the linear low-density polyethylene plant and $10.5 million in the value of an engineering division, and
- a gain of $10.3 million on the sale of a polyvinyl chloride plant.

Assets

Total consolidated assets of $4.763 billion at December 31, 1986, declined from $6.218 billion at the end of 1985. This decline is the direct result of the deconsolidation of Husky as at December 1, 1986.

Dividends

Dividends paid or payable for 1986 totalled $138.5 million compared with $138.3 million for 1985. Common share dividends were $54.4 million ($51.6 million in 1985); dividends on convertible preferred shares were $43.0 million ($43.9 million in 1985); and dividends on non-convertible preferred shares were $41.1 million ($42.8 million in 1985). In 1986 and 1985, the common shareholder received total dividends equal to 40 cents per common share.

Cash Flow

Funds provided by operations were $547.3 million compared with $609.8 million in 1985, down $62.5 million principally through reduced petroleum results.

Funds from financing activities in 1986 amounted to $198.1 million including $100.2 million in additions to long term debt, $71.8 million from the issue of Warrants of the Company and $26.1 million from the issuance of the Company's common stock.

In investment activities the Company received $157.5 million, the balance of the cash proceeds on the sale of its head office.

The total cash resources provided from operating, financing and investment activities of $896.9 million were used principally for capital expenditures of $326.4 million, the repayment of debt of $328.5 million, and the payment of dividends to shareholders ($138.5 million) and subsidiary companies' dividends to minority shareholders of $17.6 million. The consolidated cash position of the Company decreased by $2.2 million during 1986.

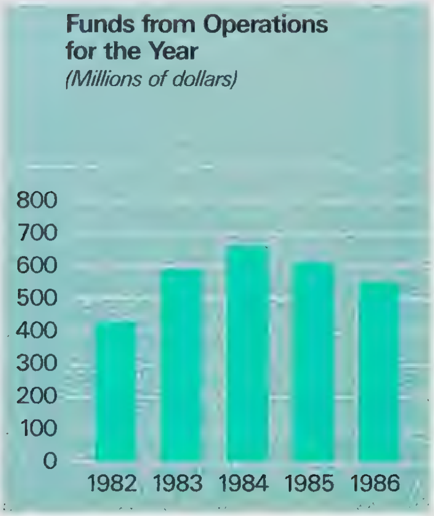
Capital Expenditures

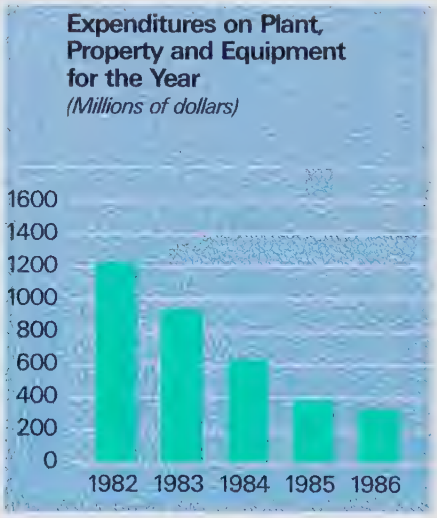
Expenditures for plant, property and equipment amounted to $326.4 million in 1986 compared with $387.3 million in 1985. The 1986 capital expenditures were incurred principally for petroleum properties and refining and marketing facilities ($182.4 million) and Alberta Gas Transmission Division facilities expansion ($75.6 million).

Share Capital

Class "A" common shares outstanding at December 31, 1986, totalled 141.8 million compared with 130.7 million in 1985.

The increase in the number of Class "A" common shares occurred primarily as a result of shares being issued under the Company's Dividend Reinvestment and Share Purchase Plan, the conversion of 6⅜% Cumulative Redeemable Convertible Second Preferred Shares and the exercise of Warrants.





Lower oil prices were largely responsible for a drop in funds from operations to $547.3 million from $609.8 million in 1985. Capital expenditures were lower, reflecting continued attention to maximizing competitive position and return on investment.

FINANCIAL REPORT

Management's Statement of Financial Reporting

The December 31, 1986, consolidated financial statements of NOVA, AN ALBERTA CORPORATION presented in the Annual Report have been prepared by management on a consistent basis in accordance with accounting principles generally accepted in Canada. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies as outlined in Note 1 to the consolidated financial statements. The financial information contained elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

The Company maintains systems of internal accounting controls, policies and procedures in order to provide, on a reasonable basis, assurance as to the reliability of the financial information and the safeguarding of assets.

Clarkson Gordon, the Company's external auditors, have examined the December 31, 1986, consolidated financial statements, and their report follows.

The Audit Committee of the Board, which comprises directors who are not employees of the Company, has reviewed the consolidated financial statements, including the notes thereto, with management and both the internal and the external auditors. The consolidated financial statements have been approved by the Board on the recommendation of the Audit Committee.

Auditors' Report

TO THE SHAREHOLDERS OF
NOVA, AN ALBERTA CORPORATION

We have examined the consolidated balance sheet of NOVA, AN ALBERTA CORPORATION as at December 31, 1986, and the consolidated statements of income, reinvested earnings, contributed surplus and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1986, and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Clarkson Gordon

Chartered Accountants
Calgary, Canada
March 16, 1987
(except as to Note 22 which is as of May 1, 1987)

Consolidated Statement of Income

(Thousands of dollars except for share data)

	Total	
Year Ended December 31	1986	1985
Revenue		
Operating revenue	$2,680,966	$3,347,236
Intersegment revenue	—	—
	2,680,966	3,347,236
Costs and expenses		
Operating expenses	1,819,347	2,288,419
Intersegment expenses	—	—
Depreciation and depletion	292,544	310,180
Petroleum and gas revenue tax (Note 16)	(25,620)	52,903
Loss on foreign currency translation	21,474	22,162
	2,107,745	2,673,664
Net operating income	573,221	673,572
Equity in earnings (losses) of affiliated companies (Note 17)	(15,204)	(7,235)
Allowance for funds used during construction	3,480	3,171
	(11,724)	(4,064)
Income before the undernoted items	561,497	669,508
Other (income) expense	14,312	(1,921)
Interest expense (net) (Note 8)	284,292	315,915
Income before income taxes, minority interest, unusual and extraordinary items	262,893	355,514
Income taxes (Note 9)		
Current	26,982	75,340
Deferred	34,632	80,552
	61,614	155,892
Income before minority interest, unusual and extraordinary items	201,279	199,622
Minority interest	63,157	65,511
Income before unusual and extraordinary items	138,122	134,111
Equity in unusual items of affiliated companies (Note 17)	(30,125)	—
Income before extraordinary items	107,997	134,111
Extraordinary items (Note 2)	(7,800)	(216,522)
Net income (loss)	$ 100,197	$ (82,411)
Earnings (loss) per common share (Note 18)		
Before extraordinary items		
Basic	$ 0.18	$ 0.38
Fully diluted	$ 0.17	$ 0.38
After extraordinary items		
Basic	$ 0.12	$ (1.31)
Fully diluted	$ 0.12	$ (1.31)

See accompanying notes to consolidated financial statements.

Gas Transportation & Marketing		Petroleum		Petrochemicals		Manufacturing	
1986	1985	1986	1985	1986	1985	1986	1985
$1,235,327	$1,527,785	$614,938	$965,228	$724,790	$756,819	$105,911	$97,404
10,102	2,172	11,215	13,658	—	—	—	—
1,245,429	1,529,957	626,153	978,886	724,790	756,819	105,911	97,404
795,900	1,077,592	355,247	508,566	570,268	623,728	97,932	78,533
5,575	9,201	734	730	15,008	5,899	—	—
97,258	91,620	130,480	138,267	59,559	74,949	5,247	5,344
—	—	(25,620)	52,903	—	—	—	—
8,026	6,066	7,133	11,889	6,315	4,207	—	—
906,759	1,184,479	467,974	712,355	651,150	708,783	103,179	83,877
338,670	345,478	158,179	266,531	73,640	48,036	2,732	13,527
—	—	2,369	—	(2,669)	(671)	(14,904)	(6,564)
3,480	3,171	—	—	—	—	—	—
3,480	3,171	2,369	—	(2,669)	(671)	(14,904)	(6,564)
$ 342,150	$ 348,649	$160,548	$266,531	$ 70,971	$ 47,365	$ (12,172)	$ 6,963

Consolidated Balance Sheet

(Thousands of dollars)

ASSETS

December 31	1986	1985
Current Assets		
Cash and short term deposits	$ 48,407	$ 44,776
Funds on deposit (Notes 8 and 22)	138,050	—
Secured bond (Note 10)	—	157,500
Accounts receivable	300,428	678,982
Inventories (Note 4)	110,441	225,417
Asset held for sale (Notes 2 and 22)	358,998	—
Prepaid expenses	6,931	7,340
	963,255	1,114,015
Long Term Investments (Note 5)	505,318	171,738
Plant, Property and Equipment (Note 6)	4,282,265	6,025,673
Less accumulated depreciation and depletion	(1,064,734)	(1,162,092)
	3,217,531	4,863,581
Other Assets (Note 7)	76,848	69,020
	$4,762,952	$6,218,354

On behalf of the Board:

Director

Director

See accompanying notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY

December 31	1986	1985
Current Liabilities		
Bank loans (Note 8)	$ 76,986	$ 71,147
16¼% Unsecured debentures (Notes 8 and 22)	138,050	—
Bank indebtedness (Note 10)	—	154,625
Accounts payable and accrued liabilities	312,361	654,801
Income taxes payable	6,022	74,549
Dividends payable	35,186	34,414
Long term debt instalments due within one year (Note 8)	69,884	91,501
	638,489	1,081,037
Long Term Debt (Note 8)	2,390,999	2,612,733
Deferred Income Taxes	53,583	425,983
Deferred Gain (Note 10)	57,535	62,359
Minority Interest in Subsidiary Companies (Note 11)	146,731	611,015
Shareholders' Equity		
Capital stock and Warrants		
Non-convertible preferred shares (Note 12)	398,379	405,096
Convertible preferred shares (Notes 12 and 22)	428,529	456,861
Common shares (Notes 13 and 22)	264,271	205,148
Warrants (Notes 14 and 22)	59,135	—
Contributed surplus	228,150	227,943
Cumulative translation adjustment (Note 15)	19,800	14,503
Reinvested earnings	77,351	115,676
	1,475,615	1,425,227
Contingencies and Commitments (Notes 2 and 21)		
	$4,762,952	$6,218,354

Consolidated Statement of Reinvested Earnings

(Thousands of dollars)

Year Ended December 31	1986	1985
Balance at beginning of year	$115,676	$336,342
Net income (loss)	100,197	(82,411)
	215,873	253,931
Less dividends paid or payable		
Preferred shares	84,071	86,636
Common shares	54,451	51,619
	138,522	138,255
Balance at end of year	$ 77,351	$115,676

Consolidated Statement of Contributed Surplus

(Thousands of dollars)

Year Ended December 31	1986	1985
Balance at beginning of year	$227,943	$228,171
Gain on purchase of preferred shares for cancellation	1,846	1,445
Capital stock and Warrants issue expenses (net of income taxes)	(1,639)	(1,673)
Balance at end of year	$228,150	$227,943

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

(Thousands of dollars)

Year Ended December 31	1986	1985
Operating activities		
Funds provided from operations (Note 19)	$547,287	$ 609,766
Other (Note 20)	(25,184)	78,896
	522,103	688,662
Financing activities		
Long term debt additions	100,189	123,788
Preferred shares issued	—	96,844
Warrants issued	71,800	—
Common shares issued	26,089	27,540
	198,078	248,172
Investment activities		
Proceeds on sale of head office building (Note 10)	157,500	1,750
Proceeds on sale of partnership interest	—	12,348
Subsidiaries and assets held for sale (Note 20)	15,894	46,429
Other	3,373	3,262
	176,767	63,789
Total cash resources provided from operating, financing and investment activities	896,948	1,000,623
Investments		
Plant, property and equipment additions (Note 23)	326,375	387,318
Other assets and long term investments	44,010	48,185
Income taxes paid on sale of subsidiary (Note 20)	—	70,000
	370,385	505,503
Financial obligations		
Repayment of bank indebtedness	154,625	—
Long term debt repayments	173,887	234,271
Preferred shares purchased for cancellation	16,034	12,318
Preferred shares of subsidiaries redeemed	28,876	25,725
Dividends—shareholders	138,522	138,255
—minority shareholders	17,599	30,064
Other (Note 20)	(772)	(2,488)
	528,771	438,145
Total cash resources used for investments and financial obligations	899,156	943,648
Increase (decrease) in cash position	(2,208)	56,975
Cash position at beginning of year	(26,371)	(83,346)
Cash position at end of year	$ (28,579)	$ (26,371)
Cash and short term deposits	$ 48,407	$ 44,776
Bank loans	(76,986)	(71,147)
Cash position at end of year	$ (28,579)	$ (26,371)

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements *December 31, 1986*

1. SUMMARY OF ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis in accordance with accounting principles generally accepted in Canada. The accounting policies of significance to the Company are as follows:

Principles of consolidation
The consolidated financial statements include the accounts of the Company, its subsidiaries and the proportionate share of assets, liabilities, revenues and expenses of certain joint ventures. The principal operating subsidiaries are as follows:

100% Owned
- The Alberta Gas Ethylene Company Ltd.
- A. G. Investments Ltd.
- A. G. Pipe Lines (Canada) Ltd.
- A. G. Pipe Lines Inc.
- Grove Italia S.p.A.
- Grove Valve and Regulator Company
- Novacor Chemicals Ltd.
- Novacorp International Consulting Ltd.
- Novacorp Pipelines Ltd.
- Novalta Resources Ltd.

Partially Owned
- Husky Oil Ltd.* (56.7% owned)
- Pan-Alberta Gas Ltd. (50.005% owned)

*Effective December 1, 1986, 57% of the Company's investment in Husky Oil Ltd. ("Husky") was held for sale.

Companies acquired have been accounted for using the purchase method.

Investments in the Alaska Highway Gas Pipeline Project, the Trans Québec & Maritimes Pipeline Project (TQM Pipeline) and certain petrochemical investments are accounted for by the proportionate consolidation method and, accordingly, the accounts reflect only the Company's proportionate interest in such activities. The Company's investment in the Alaska Highway Gas Pipeline Project is represented by its direct and indirect ownership in Foothills Pipe Lines (Yukon) Ltd. and its subsidiaries.

Cost of service
Gas Transportation & Marketing and certain Petrochemicals operations are subject to cost-of-service or tariff agreements. Under such agreements, as approved by governmental or regulatory bodies, the Company is entitled to recover reasonable and necessary operating expenses, cost of feedstock and fuel, depreciation, amortization, income and other taxes, foreign exchange gains or losses in respect of debt service and a rate of return on investment.

Foreign currency translation
Foreign operations which are considered financially and operationally independent of the parent have been translated to Canadian dollars using the year-end rate of exchange ("current rate") for assets and liabilities and average rates for the year for the revenues and expenses. Gains or losses resulting from these translation adjustments are deferred in a separate component of shareholders' equity (the "Cumulative Translation Adjustment" account) until there is a realized reduction of the net investment in the foreign operation.

Foreign operations which are considered financially and operationally dependent on the parent company have been translated to Canadian dollars using current rates of exchange for monetary assets and liabilities, historical rates of exchange for non-monetary assets and liabilities and average rates for the year for revenue and expenses, except depreciation and depletion which are translated at the rate of exchange applicable to the related assets. Gains or losses resulting from these translation adjustments are included in income.

Foreign denominated long term monetary items of Canadian operations are translated at the current rate of exchange. The unrealized translation gains or losses related to non-cost-of-service operations are deferred under the balance sheet caption "Other Assets" in the "Unamortized Foreign Exchange Translation Adjustments" account and are amortized over the remaining lives of the long term monetary items. For foreign denominated long term monetary items of cost-of-service operations, the exchange differential is recoverable from customers and is reported as a reduction in the associated long term monetary item.

Inventories
Inventories are carried at the lower of cost, as determined on a first-in, first-out basis, and net realizable value. Refined oil product inventory costs of Husky are determined by allocating costs to products on the basis of the relative market value of the product.

Investments
The Company accounts for its investments in Alberta Gas Chemicals Ltd., CNG Fuel Systems, NovAtel Communications Ltd. and Western Star Trucks Inc. (all 50% owned), as well as Husky (effective December 1, 1986), by the equity method. Under this method, the investment is carried at cost plus the related equity in undistributed earnings less the amortization of the excess of the purchase price over the net book value at date of acquisition. Notes receivable and other investments are carried at cost.

Plant, property and equipment
Plant, property and equipment are carried at cost. Maintenance and repair costs of a routine nature are

expensed as incurred, and renewals and betterments which extend the economic useful life of plant, property and equipment are capitalized.

Upon retirement or sale of items of plant, property and equipment, which are utilized in cost-of-service activities, the asset costs associated with such items are charged against the applicable accumulated depreciation accounts and the net proceeds of disposal are credited to accumulated depreciation. Normal retirements of depletable oil and gas properties are charged against the accumulated allowance for depletion. For other items in plant, property and equipment, upon disposition, the accounts are relieved of the asset costs and associated accumulated depreciation and any resulting charges or credits are carried to earnings.

The Company follows a full cost method of accounting for oil and gas interests whereby all costs of acquisition, exploration for and development of oil and gas reserves are capitalized within cost centres. In Canada, capitalized oil and gas costs are segregated into three major cost centres: the heavy oil areas, the frontier areas and all other areas of Canada. Such costs are limited to their recovery by future net revenues from production of proved reserves, at prices and costs in effect at the year-end date, plus the net cost of major development projects and any unproved properties less any related impairment, less associated general and administrative expenses, finance costs and income taxes.

In September 1986 the Canadian Institute of Chartered Accountants issued an Accounting Guideline for applying the full cost method of accounting in the oil and gas industry. The Company has not adopted the guideline for 1986 except for the application of the ceiling test methodology.

Depreciation and depletion

Plant, property and equipment (except for Gas Transportation & Marketing plant and intangible petroleum costs) are depreciated on a straight-line basis at annual rates varying from 4% to 33⅓% which rates are designed to write these assets off over their estimated useful lives. Depreciation for the Alberta Gas Transmission Division plant approximated a composite rate of 3.5% on costs in 1986 (1985 - 3.4%). Depreciation for the Alaska Highway Gas Pipeline - Phase I plant approximated a composite rate of 4% on costs in 1986 and 1985. Depreciation for the TQM Pipeline plant approximated a composite rate of 3.7% in 1986 and 1985.

The Company has computed depletion expense relative to intangible costs in each of the Canadian cost centres by the unit of production method based on proved reserves as estimated by the Company's engineers. Depletion expense is not calculated relative to the frontier areas of Canada until such time as economically recoverable reserves are established and production commences. Amounts determined to be impaired are charged to income.

The costs of acquiring and exploring for oil and gas reserves in each area where the Company has an interest outside of Canada are amortized on a straight-line basis at an annual rate of 20%. When it is determined that proved reserves exist, the unamortized costs will be depleted by the unit of production method. The unamortized costs of an abandoned area are charged against earnings at the time of abandonment.

Allowance for funds used during construction

For Gas Transportation & Marketing and in certain Petrochemicals operations, government or regulatory authorities provide for a return on capital invested in new plant while under construction by capitalizing, at an approved rate, an allowance for funds used during construction.

Capitalized interest

Interest is capitalized, based on long term debt interest rates, on certain oil and gas interests undergoing exploration and development activities that are not subject to depletion or amortization and on costs incurred during the construction of major additions to plant, property and equipment. Once the exploration and development activities are complete, or the facility commences operations, subsequent interest costs are charged to income.

Deferred project costs

Costs relating to projects which are expected to benefit future periods are deferred during the development phase. Deferred costs applicable to projects which have been terminated or significantly delayed are expensed.

Long term debt

Short term borrowings which are expected to be repaid from the proceeds of long term financing are included in long term debt.

Debt discount and expense are amortized over the terms of the respective issues.

Income taxes

The Company follows the deferral method of tax allocation accounting on all income except for certain Gas Transportation & Marketing and Petrochemicals operations which are subject to cost-of-service or tariff agreements. Under this method, the Company makes a full provision for income taxes deferred principally as a result of claiming capital cost allowance and exploration and development costs for income tax purposes in excess of depreciation and depletion provided in the accounts. Income taxes on certain operations subject to cost-of-service or tariff agreements, where there is reasonable expectation that all income taxes payable will be included in the future cost of service or tariff and recovered in revenues at that time, are provided on the taxes payable method whereby the income tax provision represents

only the income taxes deemed to be currently payable and thus recoverable under the billing mechanism in place. Investment tax credits are recorded as a reduction in the cost of the related asset, provided there is reasonable assurance that the credits will be realized.

Deferred gain
Profit realized from the sale/leaseback of the Company's head office building has been deferred and is being amortized over the lease term.

Petroleum incentives
Incentive recoveries from federal and provincial governments, related to exploration and development activities, are accounted for as a reduction of capital expenditures.

Incentives for current expenses and revenues, including royalty relief and production and revenue tax exemptions, are credited against the related accounts.

Amounts received from the Government of Saskatchewan relative to its oil and gas incentive regulations, which expired in 1985, have been credited against provincial royalties.

Pension plans
The Company and most of its subsidiaries maintain pension plans for substantially all employees. Charges to income are determined from actuarial valuations of the pension plans. At December 31, 1986, there were no significant unfunded liabilities with respect to any of the plans.

Earnings (loss) per common share
Basic earnings (loss) per common share before and after extraordinary items are calculated after deducting the dividend entitlement on preferred shares from the income before extraordinary items and net income (loss), respectively, and dividing the resulting amounts using the weighted average number of shares outstanding during the year. The calculation includes the Company's share of the reported income of subsidiaries based on its undiluted interest.

The calculation of earnings (loss) per common share on a fully diluted basis before and after extraordinary items also assumes conversion of those securities of the Company and its subsidiaries and the exercise of all stock options of the Company and its subsidiaries, as at the beginning of the year, which would have had a dilutive effect on basic earnings (loss) per common share.

Comparative figures
Certain comparative figures for the years ended December 31, 1985 and 1984, have been reclassified to conform to the current year's financial statement presentation.

2. EXTRAORDINARY ITEMS

(a) For the year ended December 31, 1986	*(Thousands of dollars)*
Provision for write-down to estimated net realizable value of the portion of the investment in Husky Oil Ltd. held for sale (net of income taxes of $6,900)—see Note 22.	$(7,800)

On December 3, 1986, a Memorandum of Agreement was completed as subsequently superseded by a Pre-Amalgamation Agreement (the "Agreement") signed on February 7, 1987, by certain parties, including principally the Company, Husky, Hutchison Whampoa Limited, Hongkong Electric Holdings Limited, and Union Faith Canada Holdings Ltd. ("Union"), a Canadian company owned equally by Hutchison Whampoa Limited and Hongkong Electric Holdings Ltd. Pursuant to the Agreement, the Company and Union agreed to cause, subject to certain legal and statutory requirements and necessary shareholder approvals, a reorganization of Husky whereby Husky and a newly incorporated Canadian company would amalgamate to form "New Husky". The parties to the Agreement undertook that New Husky would be a company with the following ownership: 43% by Union, 14% by other Canadian investors and 43% by Oil Term Holdings Ltd. ("Holdings"). Holdings would be approximately 56.7% controlled indirectly by the Company with the residual 43.3% owned directly or indirectly by other investors.

The Agreement specified that Husky shareholders would receive in exchange for each common share held in Husky either:

- a class of share of New Husky which would be redeemed for $11.80 in cash (the "All Cash Option") or
- a class of share of New Husky which would be exchanged for; another class of share of New Husky which would be redeemed for $6.726 in cash, a class of share of New Husky (the "New Husky Preferred Share"), representing either an interest in certain frontier and heavy oil properties (the "Long Term Properties") or a future cash payment and a class of share of New Husky (the "New Husky Convertible Share"), representing approximately 43% of the interest of a common share in Husky, which would be convertible into one common share of New Husky (the "New Husky Common Share"); each New Husky Preferred Share and New Husky Convertible Share would be exchanged for a common share of Oil Term

Investment Ltd. ("Investment") and each New Husky Convertible Share received by Investment would be exchanged for a common share of Holdings; Holdings would convert the New Husky Convertible Share into one New Husky Common Share (the "Share/Cash Option").

The Company has agreed to elect the Share/Cash Option.

To the extent that the shareholders of Husky other than the Company (the "Minority Shareholders") elect the All Cash Option, additional funds (the "Interim Financing") will be required by Holdings so that it will be able to subscribe for a sufficient number of New Husky Common Shares to bring its ownership up to 43% of New Husky. Union has agreed to cause a designate to subscribe for shares in Holdings (the "Holdings Subscribed Shares") at $5.074 per share up to a maximum of approximately $213,000,000, which will be the amount required if all the Minority Shareholders elect the All Cash Option. The Company has the option to purchase the Holdings Subscribed Shares during the twelve months from the date of the amalgamation. During the subsequent three month period the Company may be obligated to purchase any Holdings Subscribed Shares not purchased during the first twelve month period. The purchase price in both cases for these Holdings Subscribed Shares will be $5.074 per share, plus all costs associated with the Interim Financing as reduced by any distributions on the Holdings Subscribed Shares (the "Net Financing Costs"). It is the Company's intention to arrange the sale of all the Holdings Subscribed Shares during the initial twelve month period. The contingent gain or loss, if any, to the Company on the sale of the Holdings Subscribed Shares cannot be determined at this time.

The New Husky Preferred Shares held by Investment are redeemable at any time up to five years from the date of the amalgamation (the "Commencement Date") and are both redeemable and retractable at any time after the Commencement Date. The significant redemption and retraction features of New Husky Preferred Shares include the following:

(i) redeemable, at the option of New Husky, at any time prior to the Commencement Date for $81,000,000.

(ii) redeemable, at the option of New Husky, after the Commencement Date in certain circumstances, for a minimum of $54,000,000 plus interest from the Commencement Date (the "Basic Price"), to a maximum of the Basic Price plus $27,000,000.

(iii) the holders may at any time after the Commencement Date call for retraction in which case they would receive cash as detailed in (ii) above or in certain circumstances, at the option of New Husky, would receive the Long Term Properties or a part thereof together with a cash payment.

Effective December 5, 1986, the Company's Board of Directors approved the Memorandum of Agreement whereby 57% of the Company's investment in Husky was approved as being held for sale with the remainder being held as a long term investment. Accordingly for accounting purposes, effective December 1, 1986, the Company ceased to consolidate the accounts of Husky and commenced to account by the equity method for the remaining long term interest of approximately 24.4%, approximately 43% of the Company's previous investment in Husky.

Pursuant to the terms of the Agreement, the Company estimates the proceeds on disposition will include approximately $358,998,000 in cash which is shown as a current asset under the balance sheet caption "Asset Held For Sale". The Company's remaining long term interest in New Husky together with additional proceeds accruing to the Company of approximately $33,300,000 with respect to the New Husky Preferred Shares, which represents the incremental interest in the Long Term Properties based on the number of Minority Shareholders electing the Share/Cash Option as estimated by the Company based on advice from its investment advisors, has been included under the balance sheet caption "Long Term Investments". The portion of the Company's investment in Husky held for sale was written down to estimated net realizable value and, after providing for all estimated expenses relating to this transaction including the estimated cost of arranging the sale of the Holdings Subscribed Shares and the Net Financing Costs, the Company recorded an extraordinary loss of $7,800,000.

The following sets out summarized financial information of Husky:

	(Thousands of dollars)	
December 31	1986	1985
Current assets	$ 276,849	$ 411,249
Long term investments	27,768	25,716
Plant, property and equipment	1,403,539	1,541,384
Other assets	8,047	11,106
Current liabilities	(221,271)	(396,332)
Long term debt	(172,472)	(224,892)
Deferred income taxes	(309,037)	(369,217)
Shareholders' equity	$1,013,423	$ 999,014

December 31	1986	1985
	(Thousands of dollars)	
Operating revenue	$ 637,662	$ 923,277
Costs and expenses	(465,345)	(641,504)
Interest expense (net)	(7,238)	(20,118)
Income taxes	(34,010)	(135,670)
Unusual items (net)	(94,664)	—
Net income	$ 36,405	$ 125,985

(b) For the year ended December 31, 1985	*(Thousands of dollars)*
Provision for the write-down of the linear low-density polyethylene plant (net of income taxes of $144,658)	$ (157,342)
Loss on dilution of ownership in Husky Oil Ltd.	(58,921)
Provision for write-down of an engineering division (net of income taxes of $6,099)	(10,523)
Gain on disposition of polyvinyl chloride plant (net of income taxes of $2,304)	10,264
	$ (216,522)

At December 31, 1985, the Company reduced the carrying value of its investment in its linear low-density polyethylene plant to approximately $125,000,000. The Company anticipates that it will earn sufficient cash flow from operations to recover its investment.

In the second quarter of 1985, the Company recorded a non-cash deemed accounting loss relating to the dilution of its ownership in Husky. The dilution in ownership from approximately 67% to 57% was due to the conversion to common shares of Husky's 13% convertible preferred shares in June 1985.

At December 31, 1985, the Company wrote down the value of an engineering division, CanOcean Resources.

In November 1985, the Company sold its investment in a polyvinyl chloride plant.

3. PROPORTIONATE CONSOLIDATION OF CERTAIN OF THE COMPANY'S INVESTMENTS

The Company has proportionately consolidated certain of its Gas Transportation & Marketing and Petrochemicals investments. The components of the Company's consolidated statement of income and consolidated balance sheet relating to its share of the activities of these investments are shown below:

(Thousands of dollars)

	December 31		Year Ended December 31	
	Assets	Liabilities	Operating Revenue	Operating Expenses
Gas Transportation & Marketing				
1986	$706,082	$478,417	$143,764	$ 50,269
1985	732,466	495,623	151,840	49,491
Petrochemicals				
1986	141,932	90,230	60,185	49,291
1985	153,640	98,526	89,502	76,258
Totals				
1986	848,014	568,647	203,949	99,560
1985	886,106	594,149	241,342	125,749

4. INVENTORIES

December 31	1986	1985
	(Thousands of dollars)	
Gas Transportation & Marketing	$ 40,436	$ 73,981
Petroleum (Notes 2 and 22)	—	82,043
Petrochemicals	29,119	32,823
Manufacturing	40,886	36,570
	$110,441	$225,417

5. LONG TERM INVESTMENTS

December 31	1986	1985
	(Thousands of dollars)	
Alberta Gas Chemicals Ltd.	$ 9,941	$ 16,961
CNG Fuel Systems	20,341	20,046
Husky Oil Ltd. (Notes 2 and 22)	344,149	—
NovAtel Communications Ltd.	70,095	58,399
Western Star Trucks Inc.	13,083	13,461
Notes receivable and other investments	47,709	62,871
	$505,318	$171,738

6. PLANT, PROPERTY AND EQUIPMENT

(Thousands of dollars)

December 31	1986			1985
	Cost	Accumulated Depreciation and Depletion	Net	Net
Gas Transportation & Marketing				
Plant in service	$2,679,973	$ 676,534	$2,003,439	$2,014,600
Plant under construction	20,194	—	20,194	25,017
Petroleum (Notes 2 and 22)				
Petroleum properties and production equipment	207,186	44,625	162,561	1,245,110
Refining, marketing and pipeline facilities	—	—	—	288,380
Offshore drilling equipment	—	—	—	143,963
Heavy oil upgrader development costs	—	—	—	51,639
Other facilities	—	—	—	59,398
Petrochemicals	1,245,098	293,177	951,921	949,665
Manufacturing and other	129,814	50,398	79,416	85,809
	$4,282,265	$1,064,734	$3,217,531	$4,863,581

7. OTHER ASSETS

December 31	1986	1985
	(Thousands of dollars)	
Deferred project costs	$ 9,448	$ 8,496
Unamortized debt discount and expense	10,868	11,423
Unamortized foreign exchange translation adjustments	56,532	49,101
	$ 76,848	$ 69,020

8. LONG TERM DEBT

Debt Related to Cost-of-Service Operations

Represents long term debt in operations which are subject to cost-of-service or tariff agreements under which realized foreign exchange gains or losses are for the account of the customer.

Debt Related to Cost-of-Service Operations	*(Maturity)*	*(Thousands of dollars)*	
December 31		1986	1985
NOVA, AN ALBERTA CORPORATION			
Alberta Gas Transmission Division			
Unsecured Debentures			
9¾% Series 2	1990	$ 14,071	$ 14,884
9¼% Series 3	1990	12,729	13,426
8% Series 4	1991	36,409	38,366
8⅛% Series 5	1992	26,301	27,860
11⅜% Series 6	1995	45,986	48,064
17½% Series 7	1987	75,000	75,000
17¾% Series 8	1997	45,000	47,500
12⅛% Series 9	1993	100,000	100,000
16¼% (1985—U.S. $100,000)		—	139,750
10% Series B	1996	100,000	—
8¾% Series C (1986—U.S. $100,000)	1994	138,050	—
Unsecured Term Notes			
16⅛%—average (1986 and 1985—U.S. $110,000)	1987	151,855	153,725
Other loan (1986—U.S. $16,180; 1985—U.S. $20,740)	1989	22,336	28,985
		767,737	687,560
Less exchange differential recoverable from cost-of-service customers		37,899	43,224
		729,838	644,336
Foothills (Yukon)—Phase I	1996	242,149	245,033
TQM Pipeline			
First Mortgage Bonds			
13.10% Series A	1994	50,000	50,000
13.20% Series B	2004	50,000	50,000
11.70% Series C	1990	42,500	42,500
Term loans	1987	19,167	25,834
		161,667	168,334
Alberta Gas Ethylene			
Ethylene Plant I			
8¼% Secured Notes (1986—U.S. $171,188; 1985—U.S. $185,455)	1998	236,325	259,174
5⅜% First Income Debentures (1986—U.S. $171,188; 1985—U.S. $185,455)	1987	236,325	259,174
Less 8¼% certificates of deposit (1986—U.S. $171,188; 1985—U.S. $185,455) pledged as security against the First Income Debentures	1987	(236,325)	(259,174)
		236,325	259,174
Ethylene Plant II			
DCS loan (1986—U.S. $233,450; 1985—U.S. $245,722)	2004	322,278	343,396
13¾% Series A Secured Notes (1986—U.S. $41,458; 1985—U.S. $46,458)	2004	57,233	64,925
9.85% Series B Secured Notes (1986—U.S. $27,000)	2004	37,274	—
Secured bank loans		—	34,800
		416,785	443,121
		653,110	702,295
Less exchange differential recoverable from cost-of-service customers		76,596	90,486
		576,514	611,809
Other loans		52,990	56,437
		1,763,158	1,725,949

Debt Related to Non-Cost-of-Service Operations	(Maturity)	(Thousands of dollars)	
December 31		1986	1985
NOVA, AN ALBERTA CORPORATION			
Unsecured Debentures			
14% Series 10	1989	100,000	100,000
12% Series 11	1990	125,000	125,000
Unsecured Term Notes			
6¼% (1986 and 1985—Swiss Francs 175,000,000)	1991-1992	150,010	119,053
Bank loans and notes—unsecured		209,137	262,306
		584,147	606,359
Husky Oil Ltd. and subsidiaries (Notes 2 and 22)	Various	—	242,279
Novalta Resources			
Income Debentures			
(1986—U.S. $24,686; 1985—U.S. $31,705)	1987-1989	34,079	44,308
Cochin Pipe Line			
A. G. Pipe Lines (Canada) Ltd.	1998	14,016	15,168
A. G. Pipe Lines Inc. (1986—U.S. $28,351; 1985—U.S. $30,375)	2000	39,138	42,449
		53,154	57,617
Other loans	Various	26,345	27,722
		697,725	978,285
		2,460,883	2,704,234
Less instalments due within one year		69,884	91,501
		$2,390,999	$2,612,733

NOVA, AN ALBERTA CORPORATION

The proceeds from the 8¾% Series C unsecured debentures were on deposit as at December 31, 1986, and on January 7, 1987, the funds were used to redeem the 16¼% unsecured debentures which are included in current liabilities (Note 22).

The interest rate on the unsecured bank loans and notes is a function of generally prevailing money market interest rates and Canadian bank prime rates and at December 31, 1986, was approximately 8⅜% (10% at December 31, 1985).

Foothills (Yukon)—Phase I

In connection with the financing of Phase I of the Alaska Highway Gas Pipeline, Foothills Pipe Lines (Yukon) Ltd. has arranged long term financing with Canadian chartered banks. At December 31, 1986, $472,458,000 ($490,379,000 at December 31, 1985) was outstanding pursuant to this financing of which the Company's proportionate share is $242,149,000 ($245,033,000 at December 31, 1985). The repayment schedule provides for $406,474,000 of this financing, of which the Company's proportionate share is $206,149,000, to have matured by December 31, 1992, with the balance maturing December 31, 1996. This financing is secured by the assignment of the interest of Foothills (Yukon) and three of its subsidiaries in certain agreements and floating charges on their respective properties and assets. The interest rate is a function of prevailing money market interest rates and Canadian bank prime rates and at December 31, 1986, was approximately 9½% (10¾% at December 31, 1985).

TQM Pipeline

The First Mortgage Bonds and the term loans are secured by a first fixed and specific charge on the TQM Pipeline system, a pledge, charge and assignment of gas transportation service contracts and gas sales agreements and a floating charge on other property. The term loans bear interest at fluctuating rates related to Canadian bank prime rates. The interest rate at December 31, 1986, was approximately 8⅞% (9½% at December 31, 1985).

Alberta Gas Ethylene
Ethylene Plant I

The proceeds from the issuance of the 8¼% Secured Notes are invested in certificates of deposit which bear interest equivalent to that due on the Secured Notes. The Secured Notes are guaranteed by The Alberta Gas Ethylene Company Ltd. and are secured by a first fixed and floating charge on the first ethylene plant, the ethylene pipeline and related assets of Alberta Gas Ethylene and by the assignment of certain related contracts.

The 5⅜% First Income Debentures were issued simultaneously with the issuance of the Secured Notes and are secured by the certificates of deposit referred to in the previous paragraph.

The certificates of deposit and the 5⅜% First Income Debentures mature in December 1987. The proceeds from the certificates of deposit will be used to repay the First Income Debentures.

Ethylene Plant II

In respect of financing a portion of the second ethylene plant, Alberta Gas Ethylene entered into a loan agreement with DCS Capital Partnership, the partners of which are affiliates of The Dow Chemical Company, Union Carbide Corporation and Shell Canada Limited. This loan is secured, pursuant to a trust deed, by charges on certain of the proceeds of the ethylene sales contracts for the second ethylene plant, a first charge on the related performance guarantees of Dow and Union Carbide and a first fixed charge on a 76% undivided interest in the second ethylene plant and certain related agreements. The interest rate was approximately 11½% at December 31, 1986 (12⅕% at December 31, 1985).

In addition, Alberta Gas Ethylene has issued Series A Secured Notes, of which U.S. $41,458,000 were outstanding at December 31, 1986 (U.S. $46,458,000 at December 31, 1985), and issued U.S. $27,000,000 of Series B Secured Notes in 1986 which were outstanding at December 31, 1986. The Series A and Series B Secured Notes are secured, pursuant to the DCS Capital Partnership trust deed, by charges on certain of the proceeds of the ethylene sales contracts related to the second ethylene plant, a second charge on the related performance guarantees of Dow and Union Carbide and a first fixed charge on a 24% undivided interest in the second ethylene plant and certain related agreements. In addition, the Company has given a guarantee, applicable in certain events, in respect of a portion of the interest payable on the Series A and Series B Secured Notes.

Novalta Resources

Security for the Income Debentures includes natural gas properties and a general assignment of book debts. Interest on these Income Debentures varies with the London Inter Bank Offered Rate and was approximately 4⅜% at December 31, 1986 (6½% at December 31, 1985).

Cochin Pipe Line

A. G. Pipe Lines (Canada) Ltd., in connection with long term financing of its share of the cost of the Canadian segment of the Cochin Pipe Line, entered into a loan agreement with certain banks which provides for a term credit facility consisting of term loans and/or bankers' acceptances of which $14,016,000 was outstanding at December 31, 1986 ($15,168,000 at December 31, 1985). The term credit facility expires on December 31, 1998, and is secured by a first floating charge on a portion of the assets of A. G. Pipe Lines (Canada) Ltd., and a first fixed charge on certain agreements. The interest rate on the term credit facility was approximately 8½% at December 31, 1986 (10⅜% at December 31, 1985).

A. G. Pipe Lines Inc., in connection with the long term financing of its share of the cost of the United States segment of the Cochin Pipe Line, pursuant to a loan agreement, issued promissory notes of which U.S. $28,351,000 were outstanding at December 31, 1986 (U.S. $30,375,000 outstanding at December 31, 1985), which mature on various dates to December 31, 2000. These promissory notes are secured by an assignment of the interest of A. G. Pipe Lines Inc. in certain agreements (insofar as they relate to the United States segment of the Cochin Pipe Line), by the guarantee of A. G. Pipe Lines (Canada) Ltd., and by a pledge of the outstanding shares of A. G. Pipe Lines Inc. The interest rate varies with the London Inter Bank Offered Rate and was approximately 7⅜% at December 31, 1986 (8¾% at December 31, 1985).

Other Loans

Other loans at December 31, 1986, include loans of $96,653,000 ($93,174,000 at December 31, 1985) which are secured by certain assets and agreements. The average interest rate on the other loans approximated 9½% at December 31, 1986 (9¾% at December 31, 1985).

Sinking Fund and Repayment Requirements

Sinking fund and repayment requirements in respect of long term debt maturing within five years following December 31, 1986, are:
1987—$69,884,000; 1988—$96,356,000;
1989—$233,370,000; 1990—$304,258,000;
1991—$205,739,000.

Long term debt maturing in 1987 in the amount of $232,163,000 at December 31, 1986, which the Company expects to re-finance in 1987 with long term funding, has been excluded from the long term debt sinking fund and repayment requirements (Note 22).

Current Bank Loans

Current bank loans of $76,986,000 at December 31, 1986 ($71,147,000 at December 31, 1985) include loans of $60,265,000 ($56,541,000 at December 31, 1985) which are secured by certain assets and agreements.

The interest rates on the current bank loans ranged from 8¾% to 10% at December 31, 1986 (9½% to 10¾% at December 31, 1985).

Interest Expense (Net)

Year Ended December 31	1986 (Thousands of dollars)	1985
Interest on long term debt	$307,919	$336,648
Interest on short term debt	22,181	19,222
Interest capitalized	(26,510)	(18,839)
Interest income	(19,298)	(21,116)
	$284,292	$315,915

9. INCOME TAXES

For Gas Transportation & Marketing and certain of the Petrochemicals operations, charges to customers are based on cost-of-service or tariff agreements. Since income taxes related to these operations are a component of the charges, the billing for such income taxes on either a taxes payable or tax allocation basis does not affect net income.

Income tax expense varies from the amounts that would be computed by applying the Canadian federal and provincial income tax rates to income before income taxes, minority interest, unusual and extraordinary items as shown in the following table:

Year Ended December 31	1986 (Thousands of dollars)	1985
Income before income taxes, minority interest, unusual and extraordinary items	$262,893	$355,514
Less: Cost-of-service activities		
Gas Transportation & Marketing	199,267	203,304
Petrochemicals	70,460	66,240
Equity component in allowance for funds used during construction	1,859	1,587
Equity in earnings (losses) of affiliated companies	(15,204)	(7,235)
	$ 6,511	$ 91,618
Effective Canadian tax rate	48.8%	47.9%
Calculated income tax expense	$ 3,177	$ 43,885
Add (deduct) adjustments to income taxes resulting from—		
Royalties, lease rentals and mineral taxes payable to the Crown	11,848	35,797
Petroleum and gas revenue tax (Note 16)	(12,250)	24,388
Resource allowance on Canadian production income	(17,482)	(50,671)
Earned depletion	(4,831)	(9,507)
Provincial income tax abatement	2,338	4,578
Alberta royalty tax credit	(4,771)	(4,000)
Non-allowable depreciation and depletion	11,627	13,566
Earnings from foreign subsidiaries with lower effective tax rates	(2,737)	(5,047)
Utilization of losses for tax purposes	(34,762)	—
Other	(5,175)	(2,200)
	(53,018)	50,789
Add income taxes billed under cost-of-service contracts	114,632	105,103
Income tax expense	$ 61,614	$155,892

10. DEFERRED GAIN

On December 18, 1985, the Company sold its head office building in Calgary, Alberta, (the "Property") for $175,000,000. Proceeds received amounted to $1,750,000 cash, a secured bond in the amount of $157,500,000 and a second mortgage to the Company in the amount of $15,750,000. On the same date, the Company agreed to lease the Property for a term extending to December 31, 1997. On February 13, 1986, cash was received for the secured bond. This cash, after the payment of expenses, was used to repay the bank indebtedness shown as a current liability on the balance sheet at December 31, 1985.

The second mortgage to the Company of $15,750,000 bears interest at the rate of approximately 10.9%,

compounded annually. The principal sum, together with interest accrued thereon, becomes due and payable December 31, 1997. It is secured by a second fixed and specific mortgage on the Property. The second mortgage is included under the balance sheet caption "Long Term Investments" in "Notes Receivable and Other Investments".

The gain resulting from the sale/leaseback of the Property was deferred and is being amortized over the lease term. The unamortized balance was $57,535,000 at December 31, 1986 ($62,359,000 at December 31, 1985).

11. MINORITY INTEREST IN SUBSIDIARY COMPANIES

(Thousands of dollars) December 31	1986	1985
A. G. Investments Ltd.		
Canadian dollars	$ 63,750	$ 76,500
United States dollars (1986—U.S. $54,377; 1985—U.S. $65,253)	75,068	91,190
	138,818	167,690
Husky Oil Ltd. (Notes 2 and 22)	—	432,273
Other	7,913	11,052
	$146,731	$611,015

In connection with the original acquisition of Husky, A. G. Investments Ltd. issued variable rate, cumulative, redeemable, senior preferred shares. The preferred shares are redeemable at the option of A. G. Investments and are required to be redeemed as to 10% of the initial issue on September 30 of each year to 1988, with the balance payable on September 30, 1989. These shares are redeemable at the option of the holder in certain events. The dividend rate is 52% of the prime commercial lending rate of a Canadian chartered bank plus 1¼% for those shares denominated in Canadian dollars and 52% of the London Inter Bank Offered Rate of a Canadian chartered bank plus 1¼% for those shares denominated in United States dollars. The variable dividend rate approximated 5¾% at December 31, 1986 (6¼% at December 31, 1985). At December 31, 1986, the Husky shares owned by A. G. Investments have been pledged as collateral security (Note 22).

12. PREFERRED SHARES

(a) Authorized

2,000,000 cumulative redeemable non-convertible first preferred shares of a par value of $100 each.

20,500,000 cumulative redeemable non-convertible first preferred shares of a par value of $25 each.

26,120,000 cumulative redeemable convertible second preferred shares of a par value of $25 each.

5,000,000 cumulative redeemable non-convertible first preferred shares without par value (Note 14).

5,000,000 cumulative redeemable convertible second preferred shares without par value (Note 14).

(b) Issued and outstanding

December 31	*(Par value)*	*(Number of shares)* 1986	1985	*(Thousands of dollars)* 1986	1985
Non-convertible first preferred shares					
4¾% Series C (i)	$100	50,331	61,638	$ 5,033	$ 6,164
7¾% (i)	$ 25	677,871	702,531	16,947	17,564
9¾% (i)	$ 25	792,939	971,091	19,824	24,277
9.76% (i)	$ 25	1,293,578	1,389,448	32,339	34,736
7.60% (i)	$ 25	2,302,800	2,394,200	57,570	59,855
15% (i)	$ 25	2,500,000	2,500,000	62,500	62,500
11.24%	$ 25	4,000,000	4,000,000	100,000	100,000
9⅛%	$ 25	4,000,000	4,000,000	100,000	100,000
		15,617,519	16,018,908	394,213	405,096

	(Par value)	(Number of shares)		(Thousands of dollars)	
December 31		1986	1985	1986	1985
Non-convertible second preferred shares					
6⅜% (ii)	$ 25	166,633	—	4,166	—
		15,784,152	16,018,908	$398,379	$405,096
Convertible second preferred shares					
6⅜%	$ 25	—	877,650	$ —	$ 21,941
6½%	$ 25	6,946,004	7,200,525	173,650	180,013
12% (Note 22)	$ 25	10,195,170	10,196,270	254,879	254,907
		17,141,174	18,274,445	$428,529	$456,861

(i) These preferred shares are included in the Alberta Gas Transmission Division cost-of-service rate base capital structure.
(ii) The conversion privilege on the 6⅜% Preferred Shares expired on November 15, 1986.

(c) Commentary
The following is a summary of material characteristics of the issued and outstanding preferred shares:

Preferred Share Issue (i)	Par Value	Redeemable at the Company's Option (ii)	Sinking Fund and Purchase Fund Requirements (vii)
Non-convertible First Preferred Shares			
4¾% Series C	$100	at $101.00 per share	purchase obligation of $825,000 annually, to the extent the shares are available at a price not in excess of $100.00 per share; any purchase deficiency must be satisfied by partial redemption at a price of $101.00 per share within 15 days in the following year (vii) (x)
7¾%	$ 25	at $26.00 per share on or before May 15, 1989, and at reducing amounts thereafter	purchase obligation of $750,000 annually, to the extent the shares are available at a price not in excess of $25.00 per share; the purchase obligation is cumulative to a maximum of $1,500,000 (vii) (x)
9¾%	$ 25	at $25.00 per share	purchase 64,000 shares annually at a price not in excess of $25.00 per share on May 15 of each year under a cumulative mandatory sinking fund (vii) (viii) (x)
9.76%	$ 25	at $25.00 per share	purchase 96,000 shares annually at a price not in excess of $25.00 per share on November 15 of each year under a cumulative mandatory sinking fund (vii) (viii) (x)
7.60%	$ 25	at $25.50 per share on or before February 15, 1987, and at reducing amounts thereafter	purchase 90,000 shares annually at a price not in excess of $25.00 per share (vii) (x)
15%	$ 25	on or after August 15, 1987, to August 15, 1988, at $26.50 and at reducing amounts thereafter (iii)	purchase 100,000 shares annually at a price not in excess of $25.00 per share to August 15, 1987, and thereafter 4% of the outstanding balance on an annual basis (vii)
11.24%	$ 25	on or after May 15, 1988, to May 15, 1989, at $26.25 per share and at reducing amounts thereafter (iv)	purchase 80,000 shares annually at a price not in excess of $25.00 per share to May 15, 1988, and thereafter 4% of the outstanding balance on an annual basis (vii)
9⅛% (v)	$ 25	at $25.00 on or after February 15, 1990 (v)	purchase 3% of the shares outstanding annually, commencing February 16, 1995, at a price not in excess of $25.00 per share (vii)

Preferred Share Issue (i)	Par Value	Redeemable at the Company's Option (ii)	Sinking Fund and Purchase Fund Requirements (vii)
Non-convertible Second Preferred Shares			
6⅜%	$ 25	at $25.50 per share on or before November 15, 1987, and at reducing amounts thereafter	purchase 216,000 shares annually at a price not in excess of $25.00 per share (vii) (ix) (x)
Convertible Second Preferred Shares			
6½%	$ 25	at $26.00 per share on or before February 15, 1987, and at reducing amounts thereafter	purchase 240,000 shares annually at a price not in excess of $25.00 per share (vii) (ix) (x)
12%	$ 25	on or after May 15, 1987, to May 15, 1988, at $26.25 per share and at reducing amounts thereafter (vi)	purchase 204,000 shares annually, up to and including May 15, 1990, at a price not in excess of $25.00 per share and thereafter 4% of the outstanding balance on an annual basis (vii) (ix)

(i) The preferred shareholders are entitled to cumulative dividends at the respective rates set out in the titles of each issue.

(ii) Redeemable at the indicated price per share plus accrued and unpaid dividends.

(iii) The 15% Preferred Shares are retractable at the option of the holder by deposit of the shares on or before August 7, 1987, for redemption on August 15, 1987, at $25.00 per share plus accrued and unpaid dividends.

(iv) The 11.24% Preferred Shares are retractable at the option of the holder by deposit of shares on or before May 6, 1988, for redemption on May 15, 1988, at $25.00 per share plus accrued and unpaid dividends.

(v) Commencing in 1990, the dividend payment on the 9⅛% Preferred Shares will be equal to 70% of the average of the Canadian prime rate for the dividend period.

The 9⅛% Preferred Shares are retractable at the option of the holder by deposit of shares on or before February 6, 1995, for redemption on February 15, 1995, at $25.00 per share plus accrued and unpaid dividends.

(vi) The 12% Preferred Shares are redeemable on or before May 15, 1987, at $26.25 per share only if the weighted average price at which the Class "A" common shares were traded was not less than 130% of the conversion price.

(vii) The Company must make all reasonable efforts to satisfy the sinking and purchase fund requirements which cannot be purchased at prices in excess of the stated price per share plus accrued and unpaid dividends and costs of purchase.

(viii) The Company, in addition to the cumulative mandatory sinking funds, may call for redemption and redeem annually, through the operation of non-cumulative optional sinking funds, 48,000 9¾% Preferred Shares on May 15 of each year and 72,000 9.76% Preferred Shares on November 15 of each year at par value plus accrued and unpaid dividends.

The cumulative mandatory sinking fund requirements of the 9¾% and 9.76% Preferred Shares may be satisfied otherwise by the Company through acquisition in the open market or by an invitation for tenders.

(ix) The second preferred shares are convertible to Class "A" common shares on the following conversion basis:

	6½% Preferred Shares	12% Preferred Shares
Convertible Until	February 15, 1990	May 15, 1990
Preferred to Common Conversion Base		
December 31, 1985	1 for 2.586	1 for 3.380
December 31, 1986	1 for 2.715	1 for 3.380

During 1986, 675,417 6⅜% Preferred Shares were converted into 2,836,751 Class "A" common shares, 10,221 6½% Preferred Shares were converted into 27,665 Class "A" common shares and 1,100 12% Preferred Shares were converted into 3,718 Class "A" common shares.

(x) During 1986, the Company purchased for cancellation 11,307 4¾% Preferred Shares, 24,660 7¾% Preferred Shares, 178,152 9¾% Preferred Shares, 95,870 9.76% Preferred Shares, 91,400 7.60% Preferred Shares, 35,600 6⅜% Preferred Shares and 244,300 6½% Preferred Shares for an aggregate discount of $1,846,000 which has been credited to contributed surplus.

13. COMMON SHARES

(a) Authorized

300,000,000 Class "A" common shares without par value, non-voting except for the election of seven directors.
1,717 Class "B" common shares of the par value of $5.00 each.

(b) Issued and outstanding

December 31	(Number of shares) 1986	1985	(Thousands of dollars) 1986	1985
Class "A" common (Note 22)	141,839,334	130,656,702	$264,262	$205,140
Class "B" common	1,717	1,665	9	8
	141,841,051	130,658,367	$264,271	$205,148

The Class "B" common shares are precluded upon the reduction or redemption of such shares or the winding-up of the Company from participating in assets of the Company to a greater extent than the amount paid up thereon. The Class "B" common shares are divided into four Groups which are allotted: Group I to utility companies, Group II to gas export companies, Group III to gas producers and Group IV to four directors appointed by the Lieutenant Governor in Council of the Province of Alberta. Holders of Class "B" common shares have full voting rights except for the election of the seven directors elected by the holders of Class "A" common shares. The holders of Class "B" common shares Group IV have full voting rights in all circumstances.

(c) Issued during the year ended (Class "A" common shares)

December 31	(Number of shares) 1986	1985	(Thousands of dollars) 1986	1985
For cash on exercise of options granted to officers and employees	—	67,277	$ —	$ 468
For cash under the Dividend Reinvestment and Share Purchase Plan	5,141,443	4,518,987	26,088	27,072
On conversion of—				
6⅜% Preferred Shares	2,836,751	818,181	16,885	4,870
6½% Preferred Shares	27,665	387	256	4
12% Preferred Shares	3,718	—	28	—
On exercise of Warrants	3,173,055	—	15,865	—
	11,182,632	5,404,832	$59,122	$32,414

(d) Reserved (Class "A" common shares)

December 31	(Number of shares) 1986	1985
For conversion of the 6⅜% Preferred Shares	—	3,686,130
For conversion of the 6½% Preferred Shares	18,858,401	18,620,558
For conversion of the 12% Preferred Shares	34,459,675	34,463,393
For exercise of Warrants	11,826,945	—
Under the Incentive Stock Option Plan (1982), options are outstanding to officers and employees to purchase 4,486,850 common shares at prices ranging from $4.85 to $7.375 per share (4,004,850 shares at December 31, 1985, at prices ranging from $6.125 to $7.375 per share) with expiration dates between 1987 to 1993, and 403,500 common shares are reserved but unallocated (885,500 shares at December 31, 1985)	4,890,350	4,890,350
Under the Dividend Reinvestment and Share Purchase Plan	2,570,043	7,711,417
	72,605,414	69,371,848

14. WARRANTS

In July 1986, the Company issued 5,000,000 Warrants expiring in 1996 for $75,000,000 (net proceeds $71,800,000). Each Warrant entitles the holder at his option to obtain on exercise, either three Class "A" common shares at any time before July 31, 1996, or one no par value first preferred share, or in certain circum-

stances, one no par value second preferred share from August 1, 1991, to July 31, 1996. The Company may purchase for cancellation any or all of the Warrants outstanding in the market. If issued, the no par value first and second preferred shares will have a dividend rate which will float with prime and will be adjusted based on calculated trading prices for the preferred shares. The no par value first preferred shares, if issued, will be redeemable at the option of the Company on and after August 1, 1991, at $25.00 per share plus accrued and unpaid dividends. The no par value convertible second preferred shares, if issued, will be retractable at the option of the holder on July 31, 2001, at $25.00 per share plus accrued and unpaid dividends and may, under certain circumstances, be retracted at the option of the Company or be convertible on a one-to-one basis to no par value first preferred shares until July 31, 2001.

During 1986, 3,173,055 Class "A" common shares were issued on the exercise of 1,057,685 Warrants (Note 22).

15. CUMULATIVE TRANSLATION ADJUSTMENT

The change in the cumulative translation adjustment account is as follows:

(Thousands of dollars)

Year Ended December 31	1986	1985
Balance at beginning of year	$14,503	$ 5,676
Unrealized balance sheet translation gains (losses)		
Non-working capital items	(359)	3,027
Working capital items	5,876	5,800
	5,517	8,827
Realized (gains) losses		
Disposal of foreign affiliate (Note 17)	2,216	—
Dividends	(2,436)	—
	(220)	—
Balance at end of year	$19,800	$14,503

16. PETROLEUM AND GAS REVENUE TAX AND ROYALTY EXEMPTIONS

On April 8, 1986, Husky reached an agreement with the Governments of Canada, Alberta and Saskatchewan concerning the Bi-Provincial Upgrader Project. As part of this agreement the Governments agreed to provide Husky with reductions in petroleum and gas revenue tax ("PGRT") and provincial royalties aggregating $63,000,000. PGRT and crown royalty exemptions resulting from the agreement totalled $49,500,000 for 1986 which increased the Company's net income, after minority interest, by approximately $26,900,000. This includes the total PGRT exemption under this agreement of $36,000,000, of which the Company's share was approximately $20,400,000. The Government of Canada eliminated PGRT effective October 1, 1986.

17. UNUSUAL ITEMS

During 1986, the Company recorded its share of certain unusual items, net of applicable income taxes, incurred by affiliates which are accounted for by the equity method. The unusual charges consisted of the following:

	(Thousands of dollars)
Husky Oil Ltd.	
Write-down of the carrying value of frontier areas cost centre	$(18,193)
Loss on sale of semi-submersible drilling rig	(3,889)
Write-down of the carrying value of certain international cost centres	(983)
	(23,065)
Alberta Gas Chemicals Ltd.	
Loss on sale of investment in New Zealand methanol plant	(7,060)
	$(30,125)

At December 31, 1986, Husky wrote down the carrying value of its frontier areas cost centre as a result of uncertainties involving the current and near term environment for these exploration programs. In addition, in December 1986, Husky incurred a loss on the sale of a semi-submersible drilling rig and wrote off the carrying cost of certain international cost centres as a result of a lack of exploration success. Pursuant to the Company's decision on December 5, 1986, to dispose of 57% of its investment in Husky, the Company has recorded approximately 24.4% of the Husky unusual items (Note 2).

In September 1986, Alberta Gas Chemicals disposed of its 49% interest in a New Zealand methanol plant.

18. EARNINGS (LOSS) PER COMMON SHARE

Earnings (loss) per common share before and after extraordinary items are calculated after deducting the dividend entitlement on preferred shares ($84,071,000 in 1986 and $85,511,000 in 1985) from the income before extraordinary items and net income (loss), respectively, and dividing the resulting amounts using the weighted average number of common shares outstanding during the year (134,655,000 in 1986 and 128,087,000 in 1985).

19. FUNDS PROVIDED FROM OPERATIONS

(Thousands of dollars)

Year Ended December 31	1986	1985
Income before extraordinary items	$107,997	$134,111
Add (deduct) items not resulting in a flow of funds		
Depreciation and depletion	292,544	310,180
Deferred income taxes	34,632	80,552
Minority interest	63,157	65,511
Equity component in allowance for funds used during construction	(1,859)	(1,587)
Equity in (earnings) losses of affiliated companies	15,204	7,235
Equity in unusual items of affiliated companies	30,125	—
Other (net)	5,487	13,764
	$547,287	$609,766

20. CHANGES IN NON-CASH WORKING CAPITAL ITEMS HAVING A CASH EFFECT

(Thousands of dollars)

Year Ended December 31	1986	1985
Changes in non-cash working capital items		
Funds on deposit	$(138,050)	$ —
Secured bond	157,500	(157,500)
Accounts receivable	378,554	(18,744)
Inventories	114,976	(1,320)
Assets held for sale	(358,998)	111,142
Prepaid expenses	409	975
16¼% Unsecured debentures	138,050	—
Bank indebtedness	(154,625)	154,625
Accounts payable and accrued liabilities	(342,440)	(3,173)
Income taxes payable	(68,527)	(5,999)
Dividends payable	772	2,488
	(272,379)	82,494
Reclassification and other items not having a cash effect		
Estimated cash proceeds on disposition of the Husky investment less the net working capital effect from deconsolidation (Notes 2 and 22)	294,540	—
Other items	(30,679)	(24,681)
	263,861	(24,681)
Changes in non-cash working capital items having a cash effect	$ (8,518)	$ 57,813

	(Thousands of dollars)	
Year Ended December 31	1986	1985
These changes relate to the following activities:		
Operating activities	$ (25,184)	$ 78,896
Investment activities	15,894	46,429
Investments	—	(70,000)
Financial obligations	772	2,488
	$ (8,518)	$ 57,813

21. CONTINGENCIES AND COMMITMENTS

Gas Transportation & Marketing

(a) Pursuant to decisions released by the National Energy Board in 1982, approximately $108,572,000 (the Company's proportionate share) of preliminary Phase II expenditures on the Alaska Highway Gas Pipeline Project were approved to be included in the Phase I rate base. The after-tax amount of these expenditures, approximately $72,669,000, is being amortized on a straight-line basis at an annual rate of 4% and earns a 14.25% pre-tax rate of return (16% prior to July 1, 1986) on the unamortized portion. The unamortized balance at December 31, 1986, was $60,071,000 ($62,978,000 at December 31, 1985). Amounts collected, along with appropriate interest, will be repaid to the Phase I customers when Phase II commences operations. The Company's proportionate share of the after-tax contingent liability in this regard is $26,151,000 at December 31, 1986 ($21,453,000 at December 31, 1985).

Petrochemicals

(a) The Company has agreed on a cost-of-service basis under take or pay contracts to purchase, for a term extending to December 31, 1998, ethane acquired by Alberta Gas Ethylene in excess of its requirements for its ethylene plants but not exceeding approximately 8,800 barrels per day.

(b) The Company is responsible for the purchase, directly and indirectly, of approximately 38% of the output of the second ethylene plant, which amount is sufficient to meet the feedstock requirements of the linear low-density polyethylene plant.

(c) On the acquisition in 1987 of a polyethylene plant from Union Carbide Canada Limited (Note 22), the Company entered into a take or pay contract for the purchase of ethylene required by this polyethylene plant. The contract runs to December 31, 1998, and provides for a minimum take or pay of 333,000,000 pounds of ethylene per annum priced on a formula basis.

Petroleum

(a) During April 1986, Husky agreed with the Governments of Canada, Alberta and Saskatchewan to complete the engineering for the pre-construction phase of an upgrader plant, the Bi-Provincial Upgrader Project (the "Project"). As at December 31, 1986, Husky had invested $87,300,000 in the planning and design of an upgrader plant in addition to investments in the development of heavy oil properties to provide feedstock for this facility. The engineering for the pre-construction phase is expected to be completed at a total cost of approximately $100,000,000. Also pursuant to this agreement, Husky and the Governments will continue to participate in discussions with a view to the completion of the Project on a basis agreeable to all of the parties. In addition, Husky has recorded royalty reductions totalling $20,200,000 in respect of production during the period from June 6, 1984, to December 31, 1986, pursuant to an agreement with the Government of Saskatchewan which was executed on June 6, 1984. The royalties applicable to Husky's heavy oil production in Saskatchewan may be adjusted depending on the status of the Project and associated discussions with the Saskatchewan Government.

Other

(a) Various lawsuits and claims are pending by and against the Company. It is the opinion of management that final determination of these claims will not materially affect the financial position or the results of the Company.

(b) The lease for the Company's head office building in Calgary provides, among other matters, for the following:
   (i) that the Company, on or after January 1, 1995, make an irrevocable offer to purchase the Property on December 31, 1997. If the offer is accepted, the Company must pay a purchase price equal to the outstanding principal of the first mortgage on the Property, which is expected to be in the amount of $157,500,000, and assume any other outstanding permitted encumbrances registered against the Property.

(ii) that the Company is required under a tax indemnity agreement to indemnify the lessor in respect of certain matters calculated by reference to changes in Canadian tax laws in place at the time of entering into the lease and assumptions made in applying these laws including certain matters that would impact on the full availability of rent under the lease.

It is the opinion of management that the occurrence of the events described in (i) and (ii) above is remote.

(c) The Company and its subsidiaries have obligations under long term leases for certain office space and equipment. The approximate annual rental payments for the next five years, under these leases, excluding operating expenses, are disclosed below together with income from sub-leases, amounts recovered under cost-of-service operations and other eliminations.

(Thousands of dollars)

	1987	1988	1989	1990	1991
NOVA Head Office Building	$ 16,099	$ 16,099	$ 16,099	$ 17,749	$ 17,749
Other real estate and equipment	19,290	18,532	15,758	14,267	13,418
	35,389	34,631	31,857	32,016	31,167
Less income from sub-leases, amounts recovered under cost-of-service operations and other eliminations	(20,248)	(18,995)	(16,974)	(15,605)	(15,424)
	$ 15,141	$ 15,636	$ 14,883	$ 16,411	$ 15,743

22. SUBSEQUENT EVENTS

(a) On January 7, 1987, the Company redeemed the 16¼% unsecured debentures using the proceeds from the issuance of the 8¾% Series C unsecured debentures in November 1986. At December 31, 1986, the proceeds from the issuance of the 8¾% Series C unsecured debentures and the 16¼% unsecured debentures were included respectively under the balance sheet captions "Funds On Deposit" as a current asset and "16¼% Unsecured Debentures" as a current liability.

(b) On February 15, 1987, the Company repaid the $75,000,000 17½% Series 7 unsecured debentures with funds available under existing lines of credit.

(c) On February 16, 1987, the Company acquired a polyethylene plant, located in Moore Township, Ontario, and its associated business. The purchase price for the plant was approximately $30,000,000 together with an additional $25,000,000 for the associated inventories of raw materials and finished goods.

(d) On April 13, 1987, the Company announced its intention to call for redemption all of the 12% Cumulative Redeemable Convertible Second Preferred Shares (the "Shares") on May 15, 1987, at a price of $26.25 per share. The Company also announced that it has engaged three investment dealers to maintain a market bid of at least $26.375 for the Shares until the close of business on May 12, 1987. Any Shares that may be acquired by these investment dealers will be converted into Class "A" common shares of the Company.

Between December 31, 1986, and April 30, 1987, 9,331,791 Class "A" common shares of the Company were issued on the exercise of 3,110,597 Warrants.

(e) On April 30, 1987, the reorganization of Husky, as contemplated in Note 2, was completed, resulting in the following shareholdings:

(i) The Company owns 97.8% of Investment and correspondingly has a 97.8% interest in the New Husky Preferred Shares.

(ii) Investment owns 57.9% of Holdings with the remaining 42.1% of Holdings subscribed for under the Interim Financing arrangement in the amount of approximately $201,050,000.

(iii) The Company's resulting indirect beneficial interest in New Husky Common Shares amounts to 24.4%.

In addition, on May 1, 1987, the Company received $358,998,000 in cash proceeds with respect to this transaction. Concurrent with the reorganization of Husky, the Company's shares in Investment were substituted for the collateral security previously given in respect of the A.G. Investments senior preferred shares.

23. SEGMENTED INFORMATION

(a) Financial information by business segment
The management of the Company has determined that the following are the principal business segments of the Company:

Gas Transportation & Marketing—transportation and marketing of natural gas.
Petroleum—exploration, development, production, refining and marketing activities for crude oil and natural gas, together with consulting and research.
Petrochemicals—production, transportation and marketing activities for various petrochemical products.
Manufacturing—design, development, manufacture and marketing of various products primarily for use in the resource, transportation and telecommunications industries.

(Thousands of dollars)

	1986	1985	1984
Revenue:			
Gas Transportation & Marketing	$1,235,327	$1,527,785	$1,492,489
	46.1%	45.6%	39.3%
Petroleum	$ 614,938	$ 965,228	$1,607,090
	22.9%	28.8%	42.4%
Petrochemicals	$ 724,790	$ 756,819	$ 587,685
	27.0%	22.6%	15.5%
Manufacturing	$ 105,911	$ 97,404	$ 106,269
	4.0%	3.0%	2.8%
Consolidated	$2,680,966	$3,347,236	$3,793,533
	100%	100%	100%
Net operating income:			
Gas Transportation & Marketing	$ 338,670	$ 345,478	$ 347,410
	59.1%	51.3%	51.3%
Petroleum	$ 158,179	$ 266,531	$ 273,457
	27.6%	39.6%	40.4%
Petrochemicals	$ 73,640	$ 48,036	$ 63,392
	12.8%	7.1%	9.4%
Manufacturing	$ 2,732	$ 13,527	$ (7,271)
	0.5%	2.0%	(1.1%)
Consolidated	$ 573,221	$ 673,572	$ 676,988
	100%	100%	100%
Identifiable assets:			
Gas Transportation & Marketing	$2,224,273	$2,308,412	$2,398,797
	46.7%	37.1%	37.8%
Petroleum	$ 895,144	$2,270,621	$2,120,960
	18.8%	36.5%	33.4%
Petrochemicals	$1,083,575	$1,108,049	$1,462,047
	22.7%	17.8%	23.1%
Manufacturing	$ 275,641	$ 265,863	$ 154,616
	5.8%	4.3%	2.4%
Other	$ 284,319	$ 265,409	$ 206,263
	6.0%	4.3%	3.3%
Consolidated	$4,762,952	$6,218,354	$6,342,683
	100%	100%	100%

			(Thousands of dollars)
	1986	1985	1984
Plant, property and equipment additions:			
Gas Transportation & Marketing	$ 79,506 24.4%	$ 79,201 20.4%	$ 79,969 12.8%
Petroleum	$ 182,390* 55.9%	$ 295,424* 76.3%	$ 312,736* 50.1%
Petrochemicals	$ 61,429 18.8%	$ 11,313 2.9%	$ 220,592 35.4%
Manufacturing and Other	$ 3,050 0.9%	$ 1,380 0.4%	$ 10,776 1.7%
Consolidated	$ 326,375 100%	$ 387,318 100%	$ 624,073 100%

(b) Financial information by geographic area			(Thousands of dollars)
	1986	1985	1984
Revenue:			
Canada	$2,532,691 94.5%	$3,197,026 95.5%	$2,941,760 77.5%
United States	$ 83,241 3.1%	$ 87,955 2.6%	$ 754,983 19.9%
Other	$ 65,034 2.4%	$ 62,255 1.9%	$ 96,790 2.6%
Consolidated	$2,680,966 100%	$3,347,236 100%	$3,793,533 100%
Net operating income:			
Canada	$ 572,744 99.9%	$ 658,562 97.8%	$ 655,588 96.8%
United States	$ 827 0.2%	$ 6,795 1.0%	$ 24,797 3.7%
Other	$ (350) (0.1%)	$ 8,215 1.2%	$ (3,397) (0.5%)
Consolidated	$ 573,221 100%	$ 673,572 100%	$ 676,988 100%
Identifiable assets:			
Canada	$4,556,257 95.7%	$5,961,224 95.9%	$6,125,718 96.6%
United States	$ 86,097 1.8%	$ 127,479 2.0%	$ 157,132 2.5%
Other	$ 120,598 2.5%	$ 129,651 2.1%	$ 59,833 0.9%
Consolidated	$4,762,952 100%	$6,218,354 100%	$6,342,683 100%

*Net of Petroleum Incentive Program grants of $84,591 in 1986, $123,953 in 1985 and $161,703 in 1984.

Supplemental Financial Information *(unaudited)*

SUMMARIZED QUARTERLY FINANCIAL DATA

(Thousands of dollars except for share data)

Three Months Ended		March 31		June 30		September 30		December 31	
		1986	1985	1986	1985	1986*	1985	1986	1985
Operating revenue	$	788,921	873,682	639,399	808,640	641,027	796,265	611,619	868,649
Net operating income	$	131,128	163,025	165,068	164,055	152,190	176,894	124,835	169,598
Income before unusual items	$	26,257	31,593	37,033	30,726	42,532	32,492	32,300	39,300
Unusual items	$	—	—	—	—	(7,060)	—	(23,065)	—
Income before extraordinary items	$	26,257	31,593	37,033	30,726	35,472	32,492	9,235	39,300
Extraordinary items	$	—	—	—	(58,921)	—	—	(7,800)	(157,601)
Net income (loss)	$	26,257	31,593	37,033	(28,195)	35,472	32,492	1,435	(118,301)
Earnings (loss) per common share before extraordinary items									
Basic	$	0.04	0.08	0.12	0.07	0.11	0.09	(0.09)	0.14
Fully diluted	$	0.04	0.08	0.12	0.07	0.10	0.09	(0.09)	0.14
Earnings (loss) per common share after extraordinary items									
Basic	$	0.04	0.08	0.12	(0.39)	0.11	0.09	(0.15)	(1.09)
Fully diluted	$	0.04	0.08	0.12	(0.39)	0.10	0.09	(0.14)	(1.09)
Market price per common share									
High	$	7¼	7⅝	5¾	6⅝	5⅜	7	6½	7¼
Low	$	5⅝	6¼	4.60	5½	4.35	5¾	5⅛	5¾

* Restated to reflect the unusual item

OIL AND GAS ACTIVITIES

The following information provides estimated quantities of the Company's proved oil and gas reserves, which are all in Canada.

	Oil	Gas
PROVED DEVELOPED AND UNDEVELOPED RESERVES		
At January 1, 1985	2,675	229,000
Revisions of previous estimate	—	—
Extensions, discoveries and other additions	1,030	58,700
Production	(105)	(8,700)
At December 31, 1985	3,600	279,000
Revisions of previous estimate	**400**	**—**
Extensions, discoveries and other additions	**760**	**17,400**
Production	**(160)**	**(8,600)**
At December 31, 1986	**4,600**	**287,800**
PROVED DEVELOPED RESERVES		
At December 31, 1984	1,600	140,000
At December 31, 1985	2,150	153,000
At December 31, 1986	**2,500**	**149,000**

	Oil	Gas
COMPANY'S PROPORTIONATE INTEREST IN PROVED RESERVES OF COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD*		
At December 31, 1984**	27,563	76,931
At December 31, 1985**	28,253	72,134
At December 31, 1986	**21,754**	**66,409**

* Represents the Company's proportionate interest in proved developed oil and gas reserves of Husky.

** For comparative purposes the Company's indirect proportionate interest in Husky of 24.4% after the Husky reorganization has been used (Notes 2 and 22 of the Notes to Consolidated Financial Statements).

Crude oil, including natural gas liquids, is expressed in thousands of barrels. A barrel represents a stock tank barrel equivalent to 42 U.S. gallons or 35 Imperial gallons. Natural gas is expressed in millions of cubic feet measured at 60°F and 14.65 psia.

Volumes represent the net reserves owned after deduction of royalties, reversionary interests, and net profit interests owned by others.

LANDHOLDINGS

The landholding acreage of the Company and of Husky, which is accounted for by the equity method, is summarized below in thousands of acres:

	Company		Husky (2)	
	Gross (3)	Net (4)	Gross (3)	Net (4)
Canada				
Western Canada				
Alberta	1,158	577	2,474	1,489
Saskatchewan	15	10	877	828
British Columbia	4	1	249	83
Total Western Canada	1,177	588	3,600	2,400
Frontier Areas (5)				
Nova Scotia (offshore)	—	—	1,074	297
Newfoundland (offshore)	—	—	440	77
Northwest Territories	—	—	463	6
Beaufort Sea	—	—	501	41
Total Frontier Areas	—	—	2,478	421
Total Canada	1,177	588	6,078	2,821
Total International	—	—	6,897	1,929

(1) Landholding interests in gross acreage are subject to royalties and other non-working interests. Net acreage is based on the percentage interest owned in gross acreage without allowance for production payments or special limitations which may restrict the working interest.

(2) Includes 100% of Husky's landholdings. Not included are 365,031 gross acres in Alberta, Saskatchewan and British Columbia in which Husky owns overriding royalty interests.

(3) A gross acre is an acre in which a working interest is owned. The number of gross acres is the total number of acres in which an interest is owned.

(4) The number of net acres is the sum of the fractional working interests owned in the gross acres expressed in whole numbers.

(5) Exploration Agreements, which have been negotiated by Husky with the Government of Canada, began for the Atlantic offshore, Beaufort Sea and the Northwest Territories in 1984. The terms of each agreement establish a work program which includes the drilling of at least one well and the obligation to relinquish 50% of the lands during the initial term.

Ten-Year Financial Review *(Thousands of dollars except for share data)*

	1986	1985 (1)
Statement of Income		
Operating revenue	$2,680,966	3,347,236
Operating expenses	$1,819,347	2,288,419
Depreciation and depletion	$ 292,544	310,180
Petroleum and gas revenue tax	$ (25,620)	52,903
Loss (gain) on foreign currency translation	$ 21,474	22,162
Net operating income	$ 573,221	673,572
Equity in earnings (losses) of affiliated companies	$ (15,204)	(7,235)
Allowance for funds used during construction	$ 3,480	3,171
Other (income) expenses	$ 14,312	(1,921)
Interest expense (net)	$ 284,292	315,915
Income before income taxes, minority interest, unusual and extraordinary items	$ 262,893	355,514
Income taxes	$ 61,614	155,892
Minority interest	$ 63,157	65,511
Income before unusual and extraordinary items	$ 138,122	134,111
Unusual items	$ (30,125)	—
Income before extraordinary items	$ 107,997	134,111
Extraordinary income (loss)	$ (7,800)	(216,522)
Net income (loss)	$ 100,197	(82,411)
Assets		
Working capital at year end	$ 324,766	32,978
Additions to plant, property and equipment	$ 326,375	387,318
Investment in plant, property and equipment (cost)	$4,282,265	6,025,673
Investment in plant, property and equipment (net)	$3,217,531	4,863,581
Other assets (net)	$ 76,848	69,020
Total assets	$4,762,952	6,218,354
Capital Employed		
Long term debt (less due within one year)	$2,390,999	2,612,733
Deferred income taxes	$ 53,583	425,983
Deferred gain	$ 57,535	62,359
Minority interest	$ 146,731	611,015
Shareholders' equity		
Preferred shareholders	$ 826,908	861,957
Common shareholders	$ 589,572	563,270
Warrant holders	$ 59,135	—
Share Data		
Earnings per common share before extraordinary items		
Basic	$ 0.18	0.38
Fully diluted	$ 0.17	0.38
Earnings (loss) per common share after extraordinary items		
Basic	$ 0.12	(1.31)
Fully diluted	$ 0.12	(1.31)
Dividends paid per Class "A" common share	$ 0.40	0.40
Average common shares outstanding during year (thousands)	134,655	128,087
Number of common shares outstanding at year end (thousands)	141,841	130,658
Book value per common share	$ 4.16	4.31
Market value per common share		
High	$ 7¼	7⅝
Low	$ 4.35	5½

(1) Certain comparative figures for the years 1983 to 1985 have been reclassified to conform to the current year's financial statement presentation.

1984 (1)	1983 (1)	1982	1981	1980	1979	1978	1977
3,793,533	3,823,005	3,500,066	2,666,120	2,114,520	1,218,541	431,952	348,779
2,756,599	2,916,826	2,702,220	2,059,457	1,586,124	871,241	280,802	186,725
289,283	307,959	246,315	185,517	157,207	93,817	37,217	38,599
55,550	43,610	33,571	16,105	—	-	—	—
15,113	10,547	6,261	17,347	7,734	231	(6,168)	(2,184)
676,988	544,063	511,699	387,694	363,455	253,252	120,101	125,639
(6,367)	(8,605)	5,038	14,054	16,267	18,580	16,924	3,184
31,800	50,168	85,928	74,398	17,399	21,180	23,777	13,831
(1,551)	1,434	3,108	11,916	6,720	2,076	3,970	—
341,765	317,031	348,376	248,869	93,606	64,677	41,113	28,055
362,207	267,161	251,181	215,361	296,795	226,259	115,719	114,599
150,200	78,080	65,221	45,281	103,700	72,347	24,070	49,372
56,739	38,348	35,436	42,639	51,320	38,629	5,743	7,756
155,268	150,733	150,524	127,441	141,775	115,283	85,906	57,471
—	—	—	—	—	—	-	—
155,268	150,733	150,524	127,441	141,775	115,283	85,906	57,471
48,082	(115,605)	—	—	—	—	—	—
203,350	35,128	150,524	127,441	141,775	115,283	85,906	57,471
43,341	63,923	16,168	11,889	60,457	121,512	125,431	64,305
624,073	933,807	1,221,953	1,371,230	569,389	313,905	233,154	233,988
6,080,891	6,589,882	5,658,708	4,338,590	2,995,523	2,428,530	1,368,054	1,110,991
5,190,296	5,541,801	4,870,523	3,753,956	2,549,880	2,114,209	1,137,686	923,420
38,506	33,654	143,332	197,641	126,568	110,578	68,421	46,358
6,342,683	6,760,610	6,333,029	5,012,175	3,671,523	3,144,422	2,062,096	1,443,625
2,793,889	3,373,782	2,740,612	2,206,283	1,043,009	1,038,193	821,091	744,255
496,802	434,729	388,632	359,181	319,686	251,813	90,754	62,653
—	—	—	—	—	-	—	—
560,954	485,075	495,383	441,649	442,819	412,270	218,208	15,915
780,594	800,907	826,122	441,235	492,723	363,581	392,593	210,597
742,923	639,413	692,479	627,846	527,295	402,061	318,245	270,546
—	—	—	—	—	-	-	—
0.63	0.60	0.80	0.88	1.08	0.98	0.77	0.55
0.60	0.58	0.74	0.80	0.90	0.81	0.71	0.53
1.02	(0.38)	0.80	0.88	1.08	0.98	0.77	0.55
0.77	(0.38)	0.74	0.80	0.90	0.81	0.71	0.53
0.40	0.40	0.40	0.38666	0.36	0.30833	0.25907	0.2448
123,203	118,478	114,341	107,583	99,001	89,223	85,083	82,263
125,254	120,664	116,189	110,961	103,351	92,253	87,354	83,474
5.93	5.30	5.96	5.66	5.10	4.36	3.64	3.24
8⅛	9½	9⅞	14⅜	13⅜	9⅜	5½	5½
6⅜	6	5⅛	7¼	8	4⅞	4⅝	4¼

Board of Directors

Edward W. Best
Partner, Foster Research, Calgary, Alberta (Economic Research)

S. Robert Blair, C.C.
Chairman and Chief Executive Officer of the Company

R. Harold Carlyle
Retired, Calgary, Alberta

Arthur J.E. Child, O.C.
Chairman and Chief Executive Officer, Burns Foods Limited, Calgary, Alberta (Food Processor)

William H. Comrie
Chairman, The Brick Warehouse Ltd., Edmonton, Alberta (Home Furnishings Distribution)

J. Joseph Healy
President, Healy Motors Limited, Edmonton, Alberta (Transportation)

Harley N. Hotchkiss
President, Harman Resources Ltd., Calgary, Alberta (Private Investor—Oil and Gas, Real Estate and Agriculture)

William A. Howard
Senior Partner, Howard, Mackie, Calgary, Alberta (Barristers and Solicitors)

Peter L.P. Macdonnell, C.M.
Partner, Milner & Steer, Edmonton, Alberta (Barristers and Solicitors)

John R. McCaig
Chairman and Chief Executive Officer, Trimac Limited, Calgary, Alberta (Transportation and Resource Services)

Frederick A. McKinnon
Retired, Calgary, Alberta

H.J. Sanders Pearson
Chairman, Century Sales & Service Limited, Edmonton, Alberta (Industrial Tools and Fasteners Distribution); Vice Chairman of the Board of Directors of the Company

Robert L. Pierce
President of the Company

Daryl K. Seaman
Chairman, Bow Valley Industries Ltd., Calgary, Alberta (Natural Resource Services, Exploration and Development)

Corporate Officers

S. Robert Blair
Chairman and Chief Executive Officer

H.J. Sanders Pearson
Vice Chairman of the Board

Robert L. Pierce
President

William G. Wilson
Executive Vice President and Chief Financial Officer

James H. Butler
Executive Vice President

Bruce W. Simpson
Senior Vice President

Richard C. Milner
Vice President and Treasurer

John W.F. Cowell
Vice President

Alex W. Kabatoff
Vice President

Brian F. Olson
Vice President

Joan A. Dennis
Assistant Secretary and Secretary to the Board

Thomas G. Milne
Assistant Treasurer

Georges Dubé
Vice President, General Counsel and Corporate Secretary (Until June 30, 1987)

Senior Officers, Alberta Gas Transmission Division

Donald G. Olafson
Division Senior Vice President

Robert B. Snyder
Division Senior Vice President

Senior Officers, Principal Subsidiaries and Affiliates

James H. Butler
Chairman and Chief Executive Officer, Novacor Chemicals Ltd.

Gordon W. Cameron
President and Chief Executive Officer, Pan-Alberta Gas Ltd.

John E. Feick
President, Novacor Chemicals Ltd.

Luigi Fiore
Chairman, Grove Italia S.p.A.

C. Kent Jespersen
President, Foothills Pipe Lines (Yukon) Ltd.

Del Lippert
President and Chief Executive Officer, NovAtel Communications Ltd.

Donald G. Olafson
President, Novacorp International Consulting Ltd.

Arthur R. Price
President and Chief Executive Officer, Husky Oil Ltd.

Design
The Design Works
Typesetting
Duffoto Process Company Ltd.
Photography
Leah Dufresne
Production
NOVA
Printing
Mitchell Press Limited

PRINTED IN CANAD

Principal Companies in the NOVA Group

GAS TRANSPORTATION & MARKETING
Alberta Gas Transmission Division of NOVA (100%)
Novacorp Pipelines Ltd. (100%)
Foothills Pipe Lines (Yukon) Ltd. (50%)
Trans Québec & Maritimes Pipeline Inc. (50%)
Pan-Alberta Gas Ltd. (50.005%)

PETROLEUM
Husky Oil Ltd. (24.4%)
Novalta Resources Ltd. (100%)

PETROCHEMICALS
Novacor Chemicals Ltd. (100%)
The Alberta Gas Ethylene Company Ltd. (100%)
Alberta Gas Chemicals Ltd. (50%)

MANUFACTURING
Grove Italia S.p.A. (100%)
Grove Valve and Regulator Company (100%)
NovAtel Communications Ltd. (50%)
Western Star Trucks Inc. (50%)
CNG Fuel Systems (50%)

CONSULTING & RESEARCH
Novacorp International Consulting Ltd. (100%)
NOVA/Husky Research Corporation Ltd. (50%/50%)
Noval Enterprises Division of NOVA (100%)

OTHER
Novalta Property Services Ltd. (100%)

Corporate Headquarters

NOVA, AN ALBERTA CORPORATION
801 Seventh Avenue S.W.
P.O. Box 2535, Postal Station M
Calgary, Alberta T2P 2N6
(403) 290-6000
Toll-Free Number (800) 661-8686
Telex 038-21503
Telecopier (403) 290-6379

Principal Offices

ALBERTA GAS TRANSMISSION DIVISION
Operations Office
9888 Jasper Avenue
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FOOTHILLS PIPE LINES (YUKON) LTD.
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GROVE ITALIA S.p.A.
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HUSKY OIL LTD.
707 Eighth Avenue S.W.
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NOVACOR CHEMICALS LTD.
1600 - 734 Seventh Avenue S.W.
Calgary, Alberta T2P 3P9
(403) 290-8977

NOVACORP INTERNATIONAL CONSULTING LTD.
P.O. Box 2535, Postal Station M
Calgary, Alberta T2P 2N6
(403) 290-6000

NOVATEL COMMUNICATIONS LTD.
1020 Sixty-fourth Avenue N.E.
Calgary, Alberta T2E 7V8
(403) 295-4500

PAN-ALBERTA GAS LTD.
500 - 707 Eighth Avenue S.W.
Calgary, Alberta T2P 3V3
(403) 234-6600

Solicitors

HOWARD, MACKIE
Calgary, Alberta

Auditors

CLARKSON GORDON
Calgary, Alberta

NOVA, AN ALBERTA CORPORATION

Second Quarter Interim Report

Six months ended
June 30, 1986

Consolidated Financial Highlights

(Unaudited; thousands of dollars except for per share data)

	Three months ended June 30		Six months ended June 30	
	1986	1985	1986	1985
Statement of Income				
Operating revenue	$ 639,399	$ 808,640	$1,428,320	$1,682,322
Net operating income	$ 165,068	$ 164,055	$ 296,196	$ 327,080
Income before extraordinary item	$ 37,033	$ 30,726	$ 63,290	$ 62,319
Extraordinary item	$ —	$ (58,921)	$ —	$ (58,921)
Net income (loss)	$ 37,033	$ (28,195)	$ 63,290	$ 3,398
Preferred share dividend entitlement	$ 21,292	$ 21,507	$ 42,358	$ 42,720
Net income (loss) available to common shareholders	$ 15,741	$ (49,702)	$ 20,932	$ (39,322)
Share Data				
Earnings (loss) per common share				
Before extraordinary item				
Basic	$ 0.12	$ 0.07	$ 0.16	$ 0.15
Fully diluted	$ 0.12	$ 0.07	$ 0.16	$ 0.15
After extraordinary item				
Basic	$ 0.12	$ (0.39)	$ 0.16	$ (0.31)
Fully diluted	$ 0.12	$ (0.39)	$ 0.16	$ (0.31)
Dividends paid per common share	$ 0.10	$ 0.10	$ 0.20	$ 0.20
Average number of common shares outstanding (thousands)			132,196	126,738

Report to Shareholders

Chief Executive's Mid-Year Review

SUMMARY AND EARNINGS

Production and other operations for NOVA consolidated proceeded well in the first half of 1986 but were conducted within several depressed resource industry sectors. Earnings to common shares therefore continued distinctly below plan.

Net operating income for the first half of 1986, at $296 million before interest, taxes and minority interest, was 9% below the 1985 first half. This comparison is of course before the extraordinary loss recorded for 1985.

At this level of operating income, adequate funds were generated to cover all present requirements and add some investment for the future. As in last year, there is no anticipated net requirement for new borrowing this year.

Interest expense for the first half was reduced again, by 8% this year. Taxes and minority interest also decreased for the first half.

After providing for preferred dividends of $42 million, earnings available to common shares for the half were $21 million or 16 cents per common share, up 7% compared with the first half of 1985 before extraordinary item. Earnings in the second quarter, at 12 cents per common share, resumed the approximate level of the last two quarters of 1985, and this is the order of quarterly earnings expected for the remainder of 1986 under present posted commodity prices. The lower level of 4 cents earnings per common share for the first quarter of 1986 was caused mainly by the large drop in world oil prices and resulting major decline in value of petroleum product inventory and certain other non-recurring expenses of Husky Oil Ltd. (57% owned).

With the earnings outlook for the year continuing to approximately cover the established common dividend rate of 10 cents per quarter, this dividend was paid in each of the first two quarters and has been declared by the Board of Directors for payment in the third quarter.

NOVA's management continues to work extra hard for earnings growth to common shares because industry economics are extraordinarily difficult. Improvement in world and Canadian oil prices has not been relied upon in these plans, although there is much to be said for that, and at the time of writing, it may be occurring.

Opportunities for favourable re-financing actions are being taken and these will continue in 1987, as will changes to improve investment position.

WORLD OIL PRICES AND POLICIES

The direction of public policy for the western developed countries is forcing some changes in long-term strategy for each management responsible for investor ownership in petroleum and related industries in Canada.

The current public policy of the United States is apparently to let the oil marketing manoeuvres of Arab Gulf producing nations set the value of crude oil in the world and our domestic markets. In the second quarter and July, the tactics of several small nations have caused world crude oil market prices to wobble between $10 and $15 (U.S.) per barrel.

Under this policy, the outlook for the next few years is extremely uncertain. There are proposals by authorities that the world price should rise toward $20 (U.S.) in the fourth quarter of 1986 and increase thereafter. There are comments from observers that the price

could sink to $6 (U.S.) and stay there for several years.

This lack of direction, but encouragement of the lowest available price, is said to be good for the United States, Great Britain, Europe and Japan on the basis of net benefits for their economies. So far, Canada has not appeared to dissent from that point of view in national policy.

In contrast, there are other voices from nations which are simply oil importers saying that the continuation of such low and erratic pricing is a very questionable benefit, considering its damage to future supply development elsewhere in the world.

Some who speak for entirely oil importing jurisdictions say there would be net long-term benefit for consumers in developed countries if crude oil values were soon brought back up to the order of $20 (U.S.) and increased thereafter. That view has all the more merit for Canada, as a large producer as well as a consumer of oil and having vitally important regional and national reliance on developing future supply for domestic and export markets. So I support that view.

Such a price direction would also be positive for other large-population, oil-exporting countries which depend on oil export income for purchases of vital supplies. But in mid-1986, the dominant attitudes are those of the developed countries preferring oil supply at the lowest price from any source, and the effectively predatory pricing of the high production Gulf nations. We do not know how quickly these attitudes will change, while believing both attitudes should be changed.

The unfortunate consequence of the present situation is the temporary shrinking of oil exploration and new production development in the rest of the world, including Canada. This is happening all around us, and while the NOVA investments in this industry are in competitive, technically advanced and efficient companies—doing better than most in these times—the reality is that present policy in the western developed world governs the choices for re-investment.

COMMODITY PRICES AND NOVA RESULTS

The world oil price has direct impact on NOVA through its shareholding in Husky. It happens that Husky will be able to produce a reasonably good profit anyway for the full year 1986 by a number of actions. As always, there are opportunities for managements to better the situation.

One other commodity price very important to NOVA's current financial results is that of linear low-density polyethylene. After tumbling to an unexpected low price level of about 23 cents (U.S.) per pound again in the second quarter of 1986, the price of this commodity is posted to rise by 5 cents in August. Demand continues very strong throughout the industry, and our petrochemicals management and industry publications are predicting further recovery of polyethylene price.

Ethylene production by a NOVA subsidiary—the whole base of the largest new value-added industrial development in the prairies—continues steady and earns its contracted return on capital.

Natural gas prices in North America and methanol prices in the world are low and are continuing to fall in some places, including Alberta as to natural gas price. However, NOVA's investment in methanol is not huge for the size of its production facilities, and our very large capital investments in the natural gas business are in pipelines which maintain necessary service and steady income contribution during all economic seasons.

PIPELINE AND RELATED OPERATIONS

In fact, our natural gas pipeline systems and our industrial gas supply operations of Novalta

Resources are producing strong income contributions this summer after taking into account their share of lower industry-wide returns. Additionally, NOVA's gas marketing affiliate, Pan-Alberta Gas, is competing well. For example, Pan-Alberta is selling Alberta-produced gas to southern California at 100% of contract volumes in spite of residual oil offerings to the same market at as low as $8 (U.S.) per barrel. Pan-Alberta, one of the mainstay Canadian gas exporters, earns a small but steady profit for its owners and has recently eliminated all unresolved "take-or-pay" obligations. It provides another fair example of our operations proceeding well even in these most difficult times.

While Alberta-produced natural gas as a commodity is having a rough ride during 1986, there is increasing regard for the business future of this continental energy source, particularly when observing the decline of drilling activity in the United States. NOVA's major Alberta gas transmission system, the capacities of the Foothills pipeline systems and Pan-Alberta's marketing experience are a formidable team for participation in the inevitable upturn of natural gas exports to the United States as well as steady deliveries to all Canadian markets seeking new supply. Intraprovincial deliveries to industries in Alberta are increasing steadily, led by consumption in the petrochemical industry. NOVA's interests in Foothills and the Trans Québec and Maritimes pipeline system are also contributing.

OTHER BUSINESS INTERESTS

It is good to report now that our biggest and most challenging "hi-tech" investment, 50% of Alberta-based NovAtel Communications, is following successful product design with successful marketing and starting to contribute earnings. About one quarter of all cellular mobile telephones in use in the United States are NovAtel's; the 1986 sales plan of about $150 million for terminals and systems appears secure and the equipment is receiving top quality and design ratings by many of the larger buyers. Useful profit contribution is indicated for this year and expected to grow.

The 100%-owned valve manufacturing companies are still making profits this year during the worst market conditions known for a long time in the petroleum equipment supply sector. Other manufacturing and engineering enterprises have adjusted as necessary to current conditions under effective operating managements.

NOVA ORGANIZATION

At the annual meeting in May, a number of points were recorded on the further building of management and on our resolve to overcome present difficulties and resume growth in earnings in this Company, which built fast in energy-based investment and performance in the 1970s and early 1980s. Reductions in corporate expenses were described then, including a so-far exceptional reduction in management and directors' pay. Economies are being followed actively throughout the organization at all levels.

S. Robert Blair
Chairman and
Chief Executive Officer

Financial Review

Unaudited consolidated income before extraordinary item for the six months ended June 30, 1986, was $63.3 million, compared with $62.3 million for 1985, and for the three months ended June 30, 1986, amounted to $37.0 million, compared with $30.7 million for 1985. Unaudited consolidated net income after extraordinary item for the six months ended June 30, 1986, was $63.3 million, compared with $3.4 million for 1985. The 1985 results included an extraordinary loss of $58.9 million on a non-cash deemed accounting loss arising from the dilution in ownership of Husky from approximately 67% to 57%.

Earnings from Petroleum have been decreased by the worldwide drop in crude oil prices which began in the first few weeks of 1986. This decline was partially offset in Petrochemicals, where some product price improvement, increasing demand and operations improvements in 1986 brought better results to the Company's polyethylene business. Steady contributions from all the Company's cost-of-service activities continue, while improvement is being realized in the Company's telecommunications investment together with an ongoing contribution from the valve and flow control manufacturing operations.

In the first six months of 1986, the Company recorded a reduction in petroleum and gas revenue tax and provincial royalties of $28.8 million ($16.3 million after minority interest), pursuant to an agreement between Husky and the governments of Canada, Alberta and Saskatchewan regarding the Bi-Provincial Upgrader Project. Of this amount, $23.4 million ($13.3 million after minority interest) relates to the second quarter and includes $18.1 million ($10.3 million after minority interest) of petroleum and gas revenue tax which pertains to 1985 production.

After the deduction of preferred share dividend entitlement of $42.4 million, compared with $42.7 million in 1985, basic earnings per common share before extraordinary item were 16 cents in 1986 on a total of 132.2 million average common shares outstanding, compared with 15 cents on a total of 126.7 million average common shares outstanding in 1985. Basic earnings per common share after extraordinary item were 16 cents, compared with a loss of 31 cents in 1985. Earnings per common share on a fully diluted basis, both before and after extraordinary item, were 16 cents in 1986, compared with 15 cents before extraordinary item and a loss of 31 cents after extraordinary item in 1985.

Consolidated operating revenue was $1,428.3 million, down $254.0 million or 15%, principally as a result of reduced volumes of natural gas marketed to the United States and lower revenues in Petroleum through substantially depressed energy prices.

Consolidated operating expenses of $989.9 million were down $175.0 million or 15% from 1985. This reduction was mainly in Gas Transportation & Marketing which was down $157.7 million, the consequence of reduced gas export volumes. Petroleum was down $26.7 million reflecting lower refinery product costs.

Petroleum and gas revenue tax decreased by $44.8 million because of a lower effective rate and reduced crude production. In addition, Husky has received a reduction pursuant to the agreement with the Government of Canada regarding the Bi-Provincial Upgrader Project.

The loss on foreign currency translation amounted to $12.1 million, versus $11.3 million for the comparative period in 1985. After allowing for minority interest, amounts billed under cost-of-service contracts and income

taxes, this had an adverse effect of 3 cents per common share in 1986, compared with 4 cents per common share in 1985.

Net operating income of $296.2 million was down $30.9 million from the comparative period in 1985. The improved results from the Company's polyethylene plant were more than offset by the effect of falling crude oil prices and margins in Petroleum.

NOVA's share in losses of affiliated companies, accounted for on an equity basis, was $8.4 million in 1986, compared with $3.3 million in 1985. A decline in demand for transportation equipment together with lower prices for methanol more than offset the improvements in the Company's telecommunications joint venture.

Net interest expense of $146.5 million, compared with $159.2 million for 1985, was down $12.7 million principally due to the reduction in the average outstanding debt.

Income tax expense was $49.6 million, down from the $76.1 million reported in the same period in 1985, principally the result of the reduced Petroleum income.

Funds from operations for the period of $279.8 million represent an increase of $7.8 million or 3% from the same period in 1985. This increase was principally the result of improved product prices in the Company's polyethylene business.

NEW FINANCINGS

Also in July, NOVA filed a final prospectus for a $75 million offering of Warrants at a price of $15 per Warrant. Each Warrant is convertible, at the option of the holder, into either three Class "A" common shares by July 31, 1996, or one $25 preferred share on and from August 1, 1991, to and including July 31, 1996.

The Warrants will be issued in bearer form and will be transferable. The preferred shares will bear cumulative dividends from the first day of the month(s) of issue payable monthly at a rate adjusted by reference to prime and the trading price of these preferred shares, and will be redeemable at the option of the Company at any time after issue at $25 per share plus accrued and unpaid dividends.

Net proceeds of approximately $72 million from the sale of the Warrants will be used for general corporate purposes which may include the repurchase of 12% Cumulative Redeemable Convertible Preferred Shares in 1987.

Operating Review

GAS TRANSPORTATION

The Alberta Gas Transmission Division's winter construction program, completed in late March, represented some 33 pipeline projects comprising 183 miles of pipeline and expenditures of $32 million. Work on approximately 50 miles of pipeline, up to 10 inches in size, continues as part of the summer construction program.

As of June 30, 1986, $46.5 million had been spent from a total 1986 capital program now estimated to be about $81.4 million.

In July, NOVA announced a reduction in its natural gas transmission charges. By resolution of the Company's Board of Directors, return on rate base for gas transmission operations has been decreased from 13.67% to 12.91% effective June 1, 1986. The reduction was initiated by the Company in recognition of recent general reductions in costs of capital and specific favourable refinancing arrangements for certain long-term debt issues.

The new rate incorporates a 13.5% after-tax return on common equity on a 32% equity component in the capitalization. Those and other principal factors were developed in consultation with the Company's customers and the leading Alberta gas producers. The new rate recognizes the present downturn in the industry which is putting pressure on pipeline rates of return.

The producers have given NOVA assurance that they accept the consequent rates, tolls and charges as correct for the present levels of interest rates and economic circumstances in the province of Alberta.

The reduction will effectively reduce NOVA's after-tax earnings by about $4.3 million on an annual basis.

PETROLEUM

About 700 of Husky's heavy oil producing wells in Alberta and Saskatchewan were shut in earlier this year as a result of spring break-up and the oil pricing situation. However, about 300 wells were reopened recently as the price firmed somewhat and the Saskatchewan government introduced incentives related to royalties and well servicing costs.

Another positive factor affecting Husky's earnings in the second quarter was the agreement reached with the federal, Alberta and Saskatchewan governments regarding Husky's proposed heavy oil Bi-Provincial Upgrader Project. The agreement exempts Husky from petroleum and gas revenue tax of $36 million, and its royalty obligations in Alberta and Saskatchewan are each reduced by $13.5 million.

The agreement also covers pre-construction engineering costs on the upgrader plant and allows the project to continue while additional terms and conditions are negotiated. When the engineering work is completed next year, Husky's total investment in the upgrader project will be about $90 million.

PETROCHEMICALS

The Petrochemicals division is proceeding with plans to build a hydrogen production unit at Joffre, Alberta. Operating on a cost-of-service basis, the plant will process waste hydrogen currently used as plant fuel and transport it by pipeline to a nearby ammonia plant that is under construction by two other companies. The hydrogen plant is scheduled to begin production in April 1987.

August 5, 1986

Corporate Directory

S. Robert Blair
Chairman and Chief Executive Officer

Robert L. Pierce
President

John E. Feick
Senior Vice President

Dianne I. Hall
Senior Vice President and Secretary to the Board

William C. Rankin
Senior Vice President

Bruce W. Simpson
Senior Vice President

John W. F. Cowell, M.D.
Vice President, Occupational Health and Safety

Georges Dubé
Vice President, General Counsel and Corporate Secretary

Richard C. Milner
Vice President and Treasurer

Brian F. Olson
Vice President

John Patterson
Vice President and Controller

Joan A. Dennis
Assistant Secretary

Thomas G. Milne
Assistant Treasurer

Note: Peter C. Flynn and Edmond A. Lemieux, both vice presidents, are currently assigned on a full-time basis to affiliated companies.

Shareholder Information

DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

The Company has a Dividend Reinvestment and Share Purchase Plan that provides common and preferred shareholders with an opportunity to reinvest their cash dividends in Class "A" common shares at 95% of the weighted average price of Class "A" shares sold on The Toronto Stock Exchange on the dividend payment date. Shareholders may also make optional cash payments and acquire additional Class "A" shares without paying brokerage commissions.

Those wishing to obtain further information about the plan may contact: National Trust Company, Corporate Trust Services, Suite 1008, 320 Eighth Avenue S.W., Calgary, Alberta, T2P 3B2. Telephone (403) 263-1460.

The Dividend Reinvestment and Share Purchase Plan is not available to residents of the United States of America or any of the territories or possessions thereof.

INQUIRIES

Shareholders and others wishing to obtain additional information about the Company and its operations may direct inquiries to senior officers of the Company at the head office address in Calgary or call the Company's toll-free number in Canada: (800) 661-8686.

RAPPORTS EN FRANÇAIS

Veuillez vous adresser au secrétaire de la Compagnie si vous désirez recevoir un exemplaire de la version française de ce rapport.

Condensed Consolidated Balance Sheet

(Unaudited except for December 31, 1985; thousands of dollars)

	June 30 1986	December 31 1985	June 30 1985
Assets			
Current assets	$ 815,206	$1,114,015	$ 915,610
Long term investments	183,686	171,738	118,749
Plant, property and equipment (net)	4,890,521	4,863,581	5,225,835
Other assets	197,721	202,730	156,032
	$6,087,134	$6,352,064	$6,416,226
Liabilities			
Current liabilities	$ 789,394	$1,088,501	$ 863,837
Long term debt	2,735,035	2,738,979	2,852,337
Deferred income taxes	455,775	425,983	519,603
Deferred gain	59,947	62,359	—
Minority interest in subsidiary companies	625,253	611,015	614,096
	4,665,404	4,926,837	4,849,873
Shareholders' Equity			
Preferred shareholders	850,510	861,957	872,676
Common shareholders	571,220	563,270	693,677
	1,421,730	1,425,227	1,566,353
	$6,087,134	$6,352,064	$6,416,226

Consolidated Statement of Income

(Unaudited; thousands of dollars except for per share data)

	Total	
Six months ended June 30	1986	1985
Revenue—Operating revenue	$1,428,320	$1,682,322
Intersegment revenue	—	—
	1,428,320	1,682,322
Costs and expenses		
Operating expenses	989,923	1,164,918
Intersegment expenses	—	—
Depreciation and depletion	146,885	151,022
Petroleum and gas revenue tax	(16,795)	28,012
Loss on foreign currency translation	12,111	11,290
	1,132,124	1,355,242
Net operating income	296,196	327,080
Equity in losses of affiliated companies	(8,379)	(3,280)
Allowance for funds used during construction	2,091	2,214
	(6,288)	(1,066)
Income before the undernoted items	289,908	326,014
Other (income) expenses	3,956	(1,728)
Interest expense (net of interest income and interest capitalized during construction: 1986—$25,541; 1985—$22,224)	146,513	159,165
Income before income taxes, minority interest and extraordinary item	139,439	168,577
Income taxes—Current	15,962	47,299
Deferred	33,618	28,831
	49,580	76,130
Income before minority interest and extraordinary item	89,859	92,447
Minority interest	26,569	30,128
Income before extraordinary item	63,290	62,319
Extraordinary item	—	(58,921)
Net income	$ 63,290	$ 3,398
Earnings per common share before extraordinary item		
Basic	$ 0.16	$ 0.15
Fully diluted	$ 0.16	$ 0.15
Earnings (loss) per common share after extraordinary item		
Basic	$ 0.16	$ (0.31)
Fully diluted	$ 0.16	$ (0.31)

Gas Transportation & Marketing		Petroleum		Petrochemicals		Manufacturing	
1986	1985	1986	1985	1986	1985	1986	1985
$666,031	$816,780	$336,172	$460,197	$367,819	$376,382	$58,298	$28,963
878	1,512	6,523	8,898	—	—	—	—
666,909	818,292	342,695	469,095	367,819	376,382	58,298	28,963
435,108	592,771	209,061	235,740	292,749	312,389	53,005	24,018
2,717	6,198	426	426	4,258	3,786	—	—
47,739	43,764	66,857	67,010	29,738	38,533	2,551	1,715
—	—	(16,795)	28,012	—	—	—	—
5,146	3,632	3,651	5,838	3,314	1,820	—	—
490,710	646,365	263,200	337,026	330,059	356,528	55,556	25,733
176,199	171,927	79,495	132,069	37,760	19,854	2,742	3,230
—	—	—	—	(2,196)	(1,220)	(6,183)	(2,060)
2,091	2,214	—	—	—	—	—	—
2,091	2,214	—	—	(2,196)	(1,220)	(6,183)	(2,060)
$178,290	$174,141	$ 79,495	$132,069	$ 35,564	$ 18,634	$ (3,441)	$ 1,170

Note: Income taxes are provided on income from Gas Transportation & Marketing and certain Petrochemicals operations only to the extent that they are included in allowable costs of service under such contracts.

Consolidated Statement of Changes in Financial Position

(Unaudited; thousands of dollars)

Six months ended June 30	1986	1985
Operating activities		
Funds provided from operations	$279,789	$272,038
Other	(78,659)	60,152
	201,130	332,190
Financing activities		
Secured note	157,500	—
Long term debt additions	59,413	144,284
Preferred shares issued	—	96,844
Common shares issued	14,414	15,950
Less common shares issued on conversion of preferred shares	(1,224)	(1,951)
	230,103	255,127
Investment activities		
Subsidiaries and assets held for sale	—	46,429
Other	371	3,862
	371	50,291
Financial resources generated for investments and financial obligations	431,604	637,608
Investments		
Plant, property and equipment additions	171,478	177,170
Other assets and long term investments	24,042	23,008
Income taxes paid on sale of subsidiary	—	70,000
	195,520	270,178
Financial obligations		
Repayment of bank indebtedness	154,625	—
Long term debt repayments	54,916	227,176
Preferred shares purchased for cancellation	9,368	5,272
Preferred shares of subsidiaries redeemed	225	225
Dividends—shareholders	68,948	69,422
—minority shareholders	11,124	16,846
Other	(55)	(2,352)
	299,151	316,589
Total investments and financial obligations	494,671	586,767
Increase (decrease) in cash position	(63,067)	50,841
Cash position at beginning of period	(26,371)	(83,346)
Cash position at end of period	$ (89,438)	$ (32,505)

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